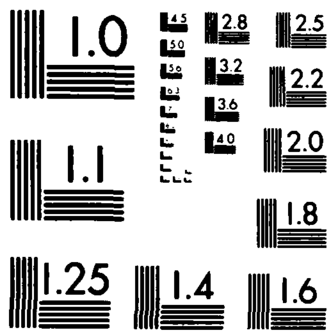
AD-A155 393 EFFECTIVE MANAGEMENT OF COMPUTER LEASING NEEDED TO REDUCE GOVERNMENT COSTS(U) GENERAL ACCOUNTING OFFICE WASHINGTON DC INFORMATION MANAGEMEN.. 21 MAR 85 1/1

UNCLASSIFIED GAO/IMTEC-85-3 F/G 9/2 NL



MICROCOPY RESOLUTION TEST CHART
NATIONAL BUREAU OF STANDARDS-1963-A

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Effective Management Of Computer Leasing Needed To Reduce Government Costs

Federal agencies spent about $1.1 billion to lease computer hardware in fiscal year 1983. GAO believes agencies that intend to retain installed computer technology can save on existing leases by:

--buying already installed equipment, where appropriate;

--refinancing existing leases;

--exercising contract options to change from lease to installment purchase; or

--reusing excess government-owned or government-leased equipment.

Although agencies can do much to improve their leasing practices, leadership, funding, and support are needed from the Office of Management and Budget and the General Services Administration to realize the potential cost savings. This report makes recommendations to the Director, Office of Management and Budget; the Administrator of General Services; and federal agency heads for actions that can help them obtain savings.

GAO/IMTEC-85-3
MARCH 21, 1985

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-199008

To the President of the Senate and the
Speaker of the House of Representatives

This report summarizes the results of our examination of federal departments' and agencies' computer leasing practices. We conducted this study because federal departments and agencies are spending more than $1 billion annually to lease computer equipment. The report points out how these costs can be substantially reduced.

We are sending copies of this report to the Director, Office of Management and Budget; Administrator of General Services; and Secretaries of Agriculture, Defense, Energy, Health and Human Services, the Interior, and the Treasury.

Charles A. Bowsher
Comptroller General
of the United States

A-1

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

EFFECTIVE MANAGEMENT OF COMPUTER LEASING NEEDED TO REDUCE GOVERNMENT COSTS

D I G E S T

The federal government can reduce its lease costs on already installed computer hardware by using alternatives to current leasing practices. Leasing alternatives would have produced 25 to 70 percent savings on a sample of leases GAO examined. Although this sample is not statistically projectable, GAO believes significant savings governmentwide are possible. The Department of Defense (DOD), which has already acted on some of GAO's recommendations, has projected net savings of nearly $1.3 billion over the next 4 years.

Federal agencies spent about $1.1 billion to lease computer hardware in fiscal year 1983; lease costs for fiscal year 1984 were estimated to have been $1.4 billion. In view of these significant costs, GAO performed a review of leasing practices between May 1982 and March 1984 to determine whether federal agencies were using the most economical financing alternatives available.

As part of this review, GAO developed a methodology for comparing the costs of five potential refinancing alternatives: renewing existing leases; exercising purchase options to buy installed equipment; carrying out sell/leaseback arrangements; and replacing installed equipment with identical equipment, either purchased or leased, from the used computer market. GAO's evaluation of the costs and benefits of these refinancing alternatives was based upon the fact that agencies intended to retain the installed computer technology to meet their immediate, foreseeable needs. Because an accurate governmentwide inventory of leased computer components was not available, GAO selected a sample of leased components which represented a mixture of equipment manufacturers, types of equipment, and types of leases. (See pp. 33-39.)

AGENCIES HAVE OPPORTUNITIES TO REDUCE LEASE COSTS

In analyzing the leases of 240 computer components installed at 8 military and 3 civilian installations, GAO found that costs could have been reduced for up to 90 percent of the components by employing one or more of the available refinancing alternatives. Potential savings on this sample ranged from $5.7 million to $19 million, depending on the length of time equipment would be retained. (See p. 7.)

Generally, the lowest cost refinancing alternative is purchase, either by exercising accumulated purchase option credits to buy installed components or by replacing components with identical equipment purchased through the used computer market. Assuming equipment in GAO's sample would be retained for 5 additional years, up to $16.4 million could have been saved by exercising contract purchase options on 213 of the 240 components. (See pp. 8-9.)

In selecting purchase over other refinancing alternatives, managers will have to consider how long they intend to keep the component, in light of changing technology and agency needs. If management perceives significant changes, then purchase may not be appropriate.

However, other refinancing alternatives do allow agencies to reduce their current lease costs while continuing to lease. For example, agencies may conduct a sell/leaseback transaction on installed equipment (in essence, using accumulated purchase option credits to acquire the equipment, then selling it to and leasing it back from a third party at a lower lease cost). Agencies may also replace components with identical equipment leased from the used computer market. Up to $14 million could have been saved on over 200 of the 240 components by refinancing, assuming the items were retained for 5 additional years. (See pp. 9-10.)

Lease costs can also be reduced by exercising contract options which change a straight lease to a lease plan that would result in ownership. By exercising such options, one

installation saved nearly $85,000. Another cost saver is replacing leased equipment with government-owned equipment no longer needed by another agency. GAO found that the General Services Administration (GSA) was giving away excess agency-owned equipment that could have been used by at least one federal agency leasing identical components. (See pp. 10-11.)

Data processing managers at the civilian and defense installations GAO visited had not identified or pursued the various refinancing alternatives open to them because they lacked the specific management procedures and monetary control policies essential to such operations. Managers were not analyzing their installed equipment leases before yearly renewal. They also were not maintaining accurate inventory records and financial and contractual data necessary to perform such analyses. Without requirements to reevaluate, these managers were reluctant to change traditional lease arrangements. Most found it easier simply to renew their existing leases. (See p. 12.)

OMB AND GSA CAN DO MORE TO ASSIST AGENCIES IN IMPROVING LEASING PRACTICES

While agencies can do much to improve their leasing practices, GSA and the Office of Management and Budget (OMB) need to provide more leadership and support to make these efforts produce the cost savings that are available.

Need for better information

GSA's data base of the government's inventory of computer equipment has been inaccurate for some time. In attempting to use the data base to select review sites, GAO initially contacted eight computer installations and found errors in the data base for six, which prevented GAO from including them in this review. For example, at two sites, equipment listed on the inventory was not installed, and officials did not know whether it had ever been installed. Also, GSA does not have contractual and financial data (e.g., accumulated purchase option credits) on the government's leased equipment. Without this information, GSA cannot fulfill its responsibilities for effectively negotiating governmentwide

contracts and placing excess owned and leased equipment with other agencies. (See pp. 21-24.)

At the installations reviewed, GAO found agency managers and officials were generally uninformed about sell/leaseback as an acquisition method or were uncertain about how a sell/leaseback could be done under procurement guidelines. (See p. 25.)

GAO also found through a questionnaire it sent to third-party dealers and lessors that over half of the 89 companies that responded were unwilling to do business with the federal government in the future. A majority of the respondents viewed some aspects of federal government procurement practices as major barriers to doing business with federal agencies. Of utmost concern were contract provisions that allowed early cancellation of a lease, for the government's convenience, with as little as 30 days' notice and no monetary penalty. GAO believes GSA must work with the third-party dealers and lessors to address these negative perceptions. Otherwise, another competitive source for reducing the cost of financing the government's equipment needs will go largely untapped. (See p. 26.)

Need for more capital in the ADP Fund

GSA and OMB have not provided agencies the funding support for unbudgeted purchase opportunities that the Congress envisioned when it passed Public Law 89-306 (the Brooks Act) and created the ADP Fund for financing the acquisition of computer equipment. The purchasing of installed, leased equipment under the Opportunity Buy Program is one of the authorized purposes for which the Fund may be used.

GSA decides, subject to OMB approval, how much of the ADP Fund capital may be used for opportunity buys. For fiscal years 1982 and 1983, GSA obtained OMB approval to use up to $4 million and $12 million, respectively, of the ADP Fund's $43 million capital to buy out uneconomical leases. GSA, however, funded only one request, for $42,643, in fiscal year 1982. It did not approve any requests in fiscal year 1983 while denying three formal agency requests totalling more than $5.1 million

because the capital was used to finance other ADP Fund programs.

Agencies have been discouraged informally from applying for ADP Fund financing. GSA officials told them that GSA probably could not fund any requests because it did not have enough money. This shortage of funds has occurred because GSA has allowed the cash needs of other ADP Fund programs over which it has discretion to tie up the entire capital of the Fund, even though GSA has not performed an analysis to determine the relative economic benefit of using the Fund to finance each program. (See pp. 26-29.)

Although the inaccuracies in agency inventory records prevented GAO from reasonably estimating the level of funds needed for unbudgeted equipment purchases, GAO believes the capital budgeted in the Fund is not sufficient. For example, nearly $2 million of the $12 million authorized in fiscal year 1983 would be needed to buy out the uneconomical leases for 100 of the 240 components in GAO's sample. Since the government's inventory of leased components is thought to exceed 90,000 items, the Fund's capital would likely be insufficient if agencies requested purchase authority where it was practical and economical to do so. (See p. 28.)

The magnitude of the funding needed is demonstrated by the Congress' provision of $150 million in special funding for DOD, which accounts for 60 percent of leased equipment governmentwide.

In June 1983 GAO told the Congress of the need to refinance uneconomical leases at defense installations. In enacting the Defense Appropriation Act in December 1983, the Congress directed DOD to develop a plan for correcting this problem. On April 1, 1984, DOD reported to the Congress that it would buy out its uneconomical leases for about $476 million and achieve an estimated net reduction of $1.24 billion in its computer costs through fiscal year 1988. (See p. 14.)

RECOMMENDATIONS

To ensure that federal civilian departments and agencies take maximum practical advantage

of available alternatives to existing leases, GAO recommends that the heads of federal agencies with substantial leasing volume (e.g., those listed on page 1) require data processing managers to

--conduct a cost-effectiveness analysis of all existing leases and develop a plan to employ, where appropriate, the refinancing alternatives described in this report, and

--correct computer equipment inventory and accounting records and maintain them accurately to enable the recurring analysis of computer leases. (See p. 16.)

To ensure that the necessary leadership and governmentwide ADP management support are forthcoming, GAO recommends that the Administrator of General Services

--issue regulations requiring all agencies, including DOD, to perform routine, periodic analyses of computer leases, compare the costs of available refinancing alternatives, and select the most reasonable, cost-effective alternative (see p. 15);

--issue guidelines for agencies in seeking third-party competition and, specifically, in transacting sell/leasebacks (see p. 31);

--identify and revise, where it will enhance competition and otherwise be appropriate, those federal contracting practices that the third-party industry believes act as major business impediments (see p. 31); and

--institute controls to ensure that the capital in the ADP Fund authorized for opportunity buys is available and used only for that purpose, unless GSA can justify to OMB that capital reserved for opportunity buys can be used more effectively for other ADP Fund programs (see p. 32).

GAO also recommends that the OMB Director

--require agency heads to confirm, with each annual budget submission, that all agency computer leases have been evaluated for cost-effectiveness, and that such leases have been contracted at the most reasonable

cost alternative available to the government (see p. 16);

--allow agencies to make greater use of the ADP Fund to purchase equipment currently leased uneconomically (see p. 32); and

--work with GSA and other federal agencies to determine and request an appropriate level of funding in the ADP Fund to buy out uneconomical leases (see p. 32).

MATTERS FOR CONSIDERATION BY THE CONGRESS

When considering future requests to increase the ADP Fund for opportunity buys, the Congress should specify that the funds be used exclusively for taking advantage of cost-effective opportunities to buy equipment.

AGENCY COMMENTS AND GAO'S EVALUATION

GAO obtained written comments from GSA, DOD, and the Departments of Health and Human Services, Energy, Agriculture, and the Interior. GAO also received oral comments from OMB. (See pp. 16-19 and 30-31.) All agencies agreed on the need to reevaluate leases periodically and to act upon the results of these analyses. (See p. 16.)

In commenting on GAO's recommendation to issue regulations requiring periodic reevaluations of leasing arrangements, GSA stated that the standard clauses in fixed-price contracts require agencies to test the marketplace before renewing contracts. GAO believes a requirement to "test the marketplace" does not connote the rigor or detail it found necessary for management to make informed cost/benefit choices. (See pp. 16-17.)

GSA disagreed on the need to institute controls to ensure that capital in the ADP Fund authorized for opportunity buys is available and used only for that purpose. According to GSA, such controls would take away the flexibility it needs to manage the Fund. GAO believes, however, that controls are necessary because the availability of capital authorized for opportunity buys is a key element in achieving the potentially significant savings

identified in this report. To provide GSA some flexibility in managing the ADP Fund while still ensuring that capital is available for opportunity buys, GAO has modified its recommendation to require GSA to seek OMB's approval to reprogram capital reserved for opportunity buys when it can justify that the capital can be used more effectively for other programs.

On a related point, OMB disagreed on the need to increase the capital in the Fund and to use it to buy out uneconomical leases. OMB believes the Fund ought to be used sparingly and only as a funding source of last resort. In its view, agencies ought to plan ahead and budget for such situations. GAO acknowledges that agencies have a basic responsibility to budget for their ADP needs and should do so to the maximum feasible extent. GAO is concerned, however, that the budget process for capital acquisitions cannot always respond to the rapid changes in the computer marketplace that make refinancing desirable. The ADP Fund offers the potential for such funding flexibility, and GAO believes its expanded use for this purpose is needed to counter an immediate and costly problem. (See pp. 30-31.)

GSA also stated that this report favors obsolescence, focusing on theoretical savings while ignoring the greater savings achievable early in product life, and ignores the long acquisition cycle, the difficulty in obtaining procurement funds, and the impact of changing technology. GAO has long recognized the significant problems associated with the growing obsolescence of federal computer systems, the long acquisition cycle, and the availability of procurement funds. GAO believes that managers need to consider intended systems life and changing technology in their decision-making and should seek the most economic alternative available. It is important to note, in this regard, that this report addresses actions which can and should be taken to reduce the costs of already acquired, leased computers which managers said they were going to retain. The issues GSA raises are important in acquiring hardware but they do not obviate GAO's concern over the fact that agencies are paying more than necessary for equipment they are already leasing and intend to keep. (See pp. 17-18).

Contents

ABBREVIATIONS

ADP	automatic data processing
ADP-MIS	Automatic Data Processing Management Information System
CDLA	Computer Dealers and Lessors Association
DOD	Department of Defense
GAO	General Accounting Office
GSA	General Services Administration
IBM	International Business Machines
OMB	Office of Management and Budget

CHAPTER 1

INTRODUCTION

Computer leasing is an increasing practice in the federal government. In fiscal year 1983, the government spent about $1.1 billion to lease general purpose computer hardware. The Office of Management and Budget (OMB) has estimated that these expenditures increased to more than $1.4 billion in fiscal year 1984. The following table shows actual and estimated computer costs for federal agencies that do substantial leasing.

Federal Agencies With Substantial Computer Leasing (millions)

Agency/ component	FY 82 (actual)	FY 83 (actual)	FY 84 (estimated)	Growth FY 82-FY 84 (percent)
Air Force	$197.5	$238.6	$316.0	60
Navy	150.1	192.8	216.6	44
Army	118.7	164.3	217.2	83
Other DOD	47.6	68.3	93.2	96
Health & Human Svcs.	104.4	104.9	129.2	24
Energy	52.5	53.7	66.9	27
Treasury	35.9	54.9	74.1	106
Agriculture	20.7	31.6	36.9	78
Interior	18.9	15.6	16.5	(13)
Other Govt.	145.1	175.3	248.0	71
Totals	$891.4	$1,100.0	$1,414.6	59

In fiscal year 1984 the Department of Defense (DOD) accounted for over 60 percent of all federal government computer leasing expenditures.

RELATIONSHIP AMONG OMB, GSA, AND FEDERAL DEPARTMENTS AND AGENCIES

The Brooks Act, Public Law 89-306, 79 stat. 1127 (1965), established a governmentwide program for the efficient and economical acquisition, use, and maintenance of automatic data processing (ADP) equipment. Under the act, OMB was given responsibility for exercising fiscal and policy control over all aspects of ADP management. Thus, agency actions related to the use and maintenance of ADP equipment are subject to OMB's review and approval. The act also gave the General Services Administration (GSA) operational responsibility for coordinating a governmentwide ADP management program, including authority to acquire general

purpose ADP equipment for other agencies' use. The act established an ADP Fund and directed GSA to use the capital in the Fund to acquire equipment needed by agencies.

The Brooks Act directs GSA to establish a management information system containing governmentwide computer inventory and fiscal data. The primary objective: to ensure that all acquisition alternatives are evaluated to provide the most economical acquisitions possible.

Under the act, federal agencies are responsible for determining how their ADP needs can best be met. Before acquiring ADP equipment by purchase or lease, agencies must first determine whether they can meet their needs by sharing already installed ADP equipment or by using excess ADP equipment.

GOVERNMENT ACQUISITION METHODS VARY

Federal departments and agencies can acquire equipment through GSA's schedule and mandatory requirements contracts or through agency-negotiated contracts. Agencies can also acquire through formally advertised procurements. Equipment leased from GSA schedules accounted for approximately 29 percent of the leased ADP expenditures in fiscal year 1982. Virtually all the balance was spent through contracts negotiated by individual departments or agencies.

GSA schedule contracts

According to the Director of GSA's Schedule Division, GSA negotiated more than 400 schedule contracts in fiscal years 1982 and 1983. By representing the government as one customer on a schedule, GSA's goal is to obtain price concessions and more favorable terms than the departments or agencies could negotiate as individual users.

It is a relatively simple matter for a data processing manager to acquire equipment through the GSA schedule contracts. After determining that other lower cost alternatives are not available, the manager need only place an order against the GSA schedule for rental or purchase of equipment. Contractors accept and fill any orders under their schedule contracts.

Department and agency-negotiated contracts

When an agency cannot meet its data processing needs through the GSA schedule contract, or if the agency believes it can obtain a better price, it can negotiate its own contract, using a Request For Proposal. The Request for Proposal calls for offers from interested manufacturers based on agency-developed specifications. The agency manager is then free to negotiate with each offeror to assemble the best possible combination of equipment and price.

The conditions and prices of a negotiated contract apply only to the department or agency that entered into the contract.

TYPES OF LEASES

According to GSA officials, the government leases most of its computer equipment from its original manufacturer and has historically renewed the leases each year. Federal departments and agencies can enter into several types of leases under these contracts:

--Straight lease. The contractor/manufacturer retains title to the equipment throughout the system life. Such plans can provide multi-year leasing at determinable prices with an agency option to renew at the end of each fiscal year.

--Lease-with-option-to-purchase. Lease with an option to purchase at predetermined intervals. The purchase price is reduced by subtracting rental credits as set forth in the contract.

--Lease-to-ownership plan. A plan whereby title transfers to the government after payment of a predetermined number of months of lease/rental, but with no agency obligation to continue to lease beyond each fiscal year.

AVAILABLE REFINANCING ALTERNATIVES

In addition to the predominant practice of leasing equipment directly from the manufacturer, agencies can take advantage of a variety of cost-effective alternatives. As the following chart shows, these alternatives involve either retaining or replacing installed equipment.

RETAINING INSTALLED EQUIPMENT	REPLACING INSTALLED EQUIPMENT
BUY--Exercise Purchase Option	BUY--Used Replacement
LEASE--Sell/Leaseback --Restructure	LEASE--Used Replacement
	REUSE--Other Government (owned or leased)

Buy, using purchase option credits

Ownership is appropriate, and generally the lowest cost option, when a manager's analysis of the agency's data processing needs indicates equipment will be kept for a long time. Most government leases provide a purchase option during the lease term and allow the agency to accumulate purchase option credits up to a percentage of the list price, usually about 50 percent. Using purchase option credits to buy equipment reduces the purchase price, sometimes substantially.

If the money necessary to exercise a purchase option is not available, an agency may be able to assign its purchase option and accumulated credits to GSA, which can exercise the option through the ADP Fund. In certain circumstances, GSA is empowered to acquire equipment through the ADP Fund and then lease the equipment back to the agency or department at a rate that recovers the purchase price and a nominal service charge.

Refinance, using sell/leaseback transactions

Refinancing an existing lease, through the use of sell/leaseback, sometimes results in substantial savings. Most current lease contracts provide a purchase option during the lease term and allow the agency to accumulate purchase option credits. These credits are assets that can be used to reduce the acquisition cost of the equipment up to 50 percent or more. Using the accumulated credits, a third-party vendor, investor, or financial institution can buy the equipment at a lower price and pass the savings along to the government in the form of lower rental rates.

The sell/leaseback transaction requires the agency to (1) exercise the option and sell the equipment to a third party, (2) assign purchase option credits to a third party, or (3) designate a third party as the agency's agent to exercise the purchase option. The third party buys the equipment and leases it back to the agency at a more favorable rental rate. This lease can be an operating lease or installment purchase, depending on the agency's desired ownership position at the end of the lease term.[1] Although sell/leaseback transactions are prevalent in private industry, they are rarely used by the federal government. One instance occurred in 1980 when the Lawrence Livermore National Laboratory saved more than $2 million by using a sell/leaseback to refinance a "supercomputer." We were told this was done in response to budget cuts in the program being supported by this computer.

---

[1]See 55 Comp.Gen. (1976) 1012 for further details on sell/leaseback transactions.

Restructure a lease by changing terms and conditions

Restructuring the original lease through the manufacturer can enable federal agencies to reduce computer lease costs. Restructuring is simply changing the terms and conditions of an existing lease on an installed component to effect a lower lease rate, either through negotiation or by changing from one published lease plan to another.

An example of the latter of these two approaches is converting equipment from a lease-with-option-to-purchase contract to a lease-to-ownership plan under the GSA schedule. By restructuring the lease with the manufacturer, the monthly payments are reduced and the government owns the equipment at the end of the lease term. The Air Force's San Antonio Data Services Center saved almost $85,000 over the estimated remaining life of some of its equipment by converting from a lease-with-option-to-purchase to lease-to-ownership plan to restructure its lease on two IBM 4341 systems.

Buy or lease used equipment

Managers can acquire and replace components or systems at rates lower than those available from the manufacturers through the third-party industry. This industry deals primarily with International Business Machines (IBM) equipment; however, other manufacturers' equipment is also available. Data processing managers at a major university we visited reported they were able to buy a used Amdahl processor for $135,000 less than an identical machine would have cost new from the manufacturer.

Reuse government-owned or government-leased equipment

Departments and agencies can also lower their ADP costs in some cases by replacing equipment being leased from the manufacturer with excess equipment owned or leased by the government. GSA's Excess Equipment Branch acts as a clearinghouse to advertise the availability of this equipment governmentwide.

Government-owned equipment can sometimes be transferred for reuse at little or no cost to the acquiring agency. Other government-owned equipment may be transferred through an exchange/ sale arrangement, whereby interested agencies may obtain the equipment from another agency at a price equal to the trade-in value. This price may be substantially less than the price of a new acquisition.

Government-leased ADP equipment may also be transferred for reuse. Equipment under lease-with-option-to-purchase contracts

sometimes accrues substantial purchase option credits. Agencies may be able to obtain this equipment from another agency and continue to lease it or use the accrued credits to purchase it.

OBJECTIVES, SCOPE, AND METHODOLOGY

In this review, we looked at the viability of reducing federal data processing equipment lease costs by seeking alternatives to current leasing practices. Beginning in May 1982, we collected contract and payment data on a judgmental sample of 240 leased computer components installed at 11 different federal data processing installations. The components selected provided a mix of manufacturers, equipment types, age, and contract types. We then developed a methodology for comparing the costs of five potential refinancing alternatives for each of these components. Our objective was to identify savings opportunities by

- --defining various refinancing alternatives through discussions with federal, state, local, and private-sector data processing managers, as well as representatives of computer manufacturers and computer dealers and lessors;

- --analyzing instances in which leasing alternatives have been successfully employed in government and the private sector to reduce costs; and

- --developing a methodology for screening installed, leased equipment to identify alternative leasing candidates.

We conducted this study in accordance with generally accepted government auditing standards between May 1982 and March 1984. Our objectives, scope, and methodologies are discussed in more detail in appendix I.

CHAPTER 2

AGENCIES HAVE OPPORTUNITIES TO

REDUCE LEASE COSTS

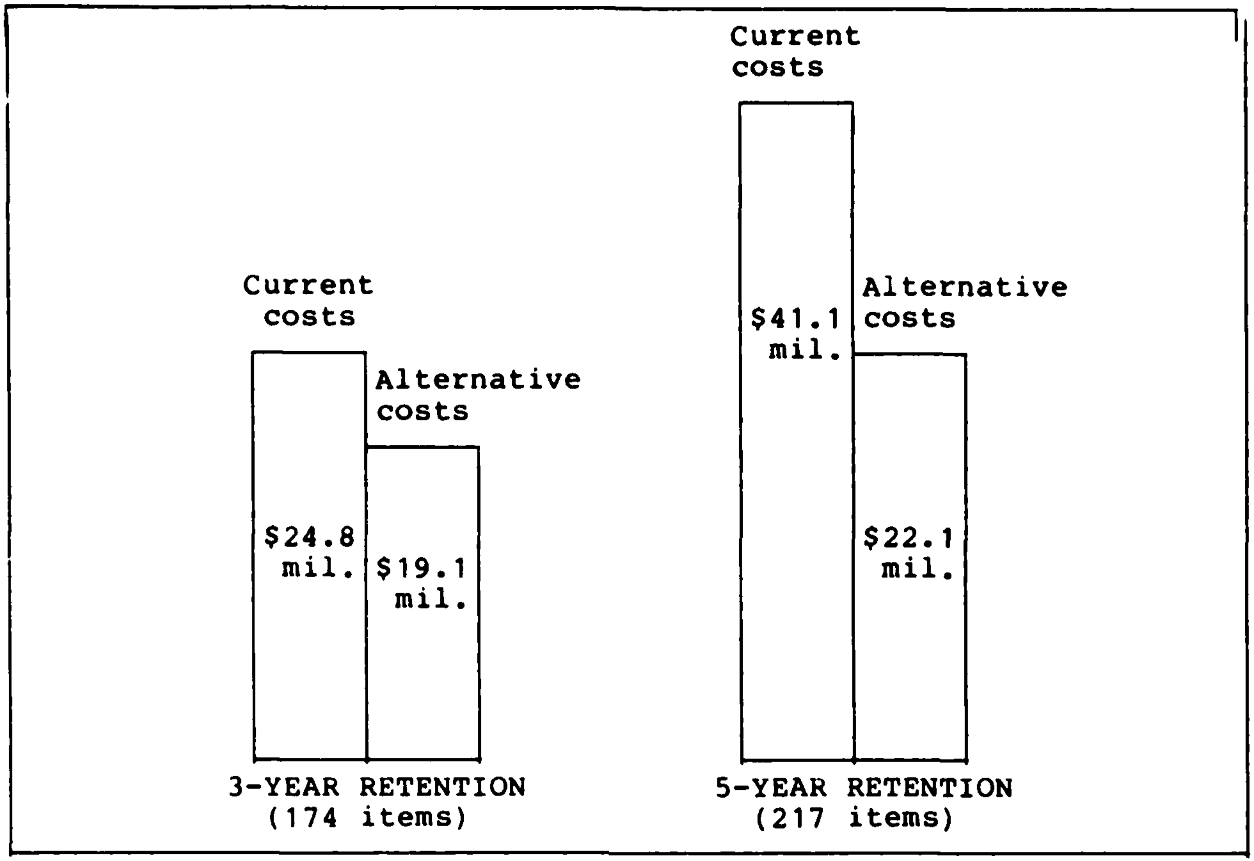
The federal departments and agencies we reviewed did not take advantage of lease and buy opportunities that could have reduced computer component lease costs by 25 to 70 percent. Managers of the data processing installations we visited had not identified or pursued these alternatives because they were not analyzing their installed equipment leases, and they lacked both the information and requirement to do so. We analyzed the leases of 240 computer components installed at 8 military and 3 civilian installations and found that costs could have been reduced for up to 90 percent of the components by employing one or more available refinancing alternatives. Potential savings on this sample ranged between $5.7 million and $19 million. While our sample is not statistically projectable, we believe significant savings are available governmentwide.

In response to our findings and to direction from the Congress, DOD reevaluated its leases and has projected net savings of nearly $1.3 billion over the next 4 years.

DATA PROCESSING MANAGERS MISSED COST-CUTTING OPPORTUNITIES

Our analysis of the 240 components showed that for 70 to 90 percent, costs could have been substantially reduced by using one of the refinancing alternatives, if the items were retained an additional 3 to 5 years. We assumed this retention period would be met because the sampled items had been installed an average of 2.7 years at the time of our analysis, and installation managers expected to keep them for an average of 3.3 additional years. Moreover, prior GAO work and other governmental studies show that equipment is generally retained even longer than this average.

Assuming a 3-year retention life, we found at least one refinancing alternative was cheaper for more than 72 percent of the 240 items; if retained for 5 years, at least one alternative was cheaper in 90 percent of the cases. On an item-by-item basis, the net savings for these components, using the least-cost refinancing alternative, ranged between 25 and 70 percent, with some as high as 90 percent. As shown in the chart on the following page, the total that could be saved on these items, assuming retention periods of 3 and 5 years, is about $5.7 million and $19 million, respectively.



The above chart displays only the current lease cost compared to the least-cost refinancing alternative; the following sections discuss how much money can possibly be saved under each separate alternative.

Cost savings through purchase have not been realized

Generally, the lowest cost refinancing alternative is purchase, either by exercising accumulated purchase option credits to buy installed components or by replacing components with identical equipment purchased through the used computer market. In selecting purchase over other refinancing alternatives, though, managers will have to consider how long they plan to keep the components, in light of changing technology and agency needs. Care must be taken that each case is evaluated on its own merit. In our sample of 240 components, most could have been purchased at substantial savings.

Exercising purchase option credits

Up to $16.4 million could have been saved by exercising contract purchase option provisions on the 213 components for which purchase was less costly than the current lease:

3-YEAR SAVINGS (160 items) ////// $3.3 million

5-YEAR SAVINGS (213 items) ///// $16.4 million //////////

For example, a Honeywell disk subsystem at Headquarters, Military Airlift Command, had been installed for just over 2 years under a negotiated lease-with-option-to-purchase contract. During that time, it had accumulated purchase option credits worth more than 50 percent of its $125,000 purchase price. We were told that this component would be retained for more than 5 additional years. Our analysis showed that by exercising the purchase option, the Air Force would save approximately $129,000, or 70 percent, by the end of the fifth year of continued use. Yet, the contract that covered this and other components with similar economic characteristics had been renewed for continued lease.

Purchasing used equipment

Up to $12.7 million could have been saved on 48 of the items by purchasing identical equipment on the used computer market:

3-YEAR SAVINGS (47 items) ////// $3.5 million

5-YEAR SAVINGS (48 items) //// $12.7 million ///

In addition, the used computer market price for 38 out of 48 items in our sample was less than the government's purchase option exercise price.

Cost comparisons between third-party prices for used equipment and current rental for leased equipment dramatically illustrate the savings made possible by purchasing used equipment. For example, IBM 1403 printers were being leased at two sites we visited. If the sites used purchase option credits, then they could buy each printer for at least $17,206. The current lease rate (net of maintenance) is $7,524 per year. These printers can be purchased from the third-party industry for about $2,500. Thus, in a single year, $5,024, or 67 percent, could be saved for each printer purchased through the third-party market.

Cost savings through lease refinancing have not been realized

If purchase is not an appropriate refinancing alternative, federal managers can still reduce their costs while continuing to lease. They may either conduct a sell/leaseback transaction on installed equipment (in essence, using accumulated purchase option

credits to reduce future rents) or they may replace components with identical equipment leased from the used computer market. In our sample of 240 items, more that 200 could have been retained under lease at lower cost by refinancing.

Sell/leaseback capitalizes on purchase option credits

Up to $14 million could have been saved on 207 items within our sample by conducting a sell/leaseback transaction:

3-YEAR SAVINGS (148 items) //// $2.7 million

5-YEAR SAVINGS (207 items) //////$14 million//////////

One specific illustration of the potential for cost reduction was a Control Data memory component installed at Eglin Air Force Base in Florida. The memory component was being leased under a GSA schedule contract for $79,500 a year, and the installation intended to keep it for over 3 more years. Had the installation refinanced the component using a sell/leaseback transaction, it could have reduced its annual rental payments by almost $34,000, a 43-percent reduction.

Used equipment leases for less

Readily identifiable used replacements were available for 48 computer components, installed at the various installations we visited. For 47 of these, the used equipment rental price, calculated from the published price for the used replacement, was less than the current rental cost, and up to $11.3 million could have been saved.

3-YEAR SAVINGS (46 items) //// $2.6 million

5-YEAR SAVINGS (47 items) //// $11.3 million////

For example, two IBM optical page readers were rented directly from the manufacturer at rates ranging from $507 to $564 a month. Similar used equipment could have been purchased for about $1,000 or leased for a nominal rate.

Changing the terms and conditions
can also reduce lease costs

Restructuring an original lease through the manufacturer enabled at least one federal activity in our sample to reduce its computer lease costs. The Air Force's San Antonio Data Services Center saved almost $85,000 over the estimated remaining life of

some of its equipment by converting from a lease-with-option-to-purchase to a lease-to-ownership plan on two IBM 4341 systems. The center converted its IBM equipment to that company's federal lease-to-ownership plan, starting in October 1982. The conversion resulted in a rental savings of $3,439 per month, and the Air Force will own the computers at the end of the plan. In all, 5 of the 11 sites we visited had leased IBM components that were eligible for restructuring, and similar results may have been possible in other instances. For example, the Military Airlift Command at Scott Air Force Base in Illinois could have saved $105 a month on an IBM tape drive and owned the drive outright in less than its estimated remaining life.

Managers could have further reduced lease costs through reuse

GSA documents show that reusing excess equipment saves money. In fiscal year 1982, for example, GSA reported cost avoidances of about $14.9 million from 1,606 reuse transactions. Federal agencies have not, however, considered using excess ADP equipment to meet their needs in all instances.

We found that some agencies leased equipment from the manufacturer, even though they could have obtained identical excess equipment from GSA for little or no cost. For instance, GSA purchased 6,249 IBM punch card accounting machines in 1980 and has been making these machines available at minimal or no cost as they are declared available for reuse. Since November 30, 1982, all such equipment transfers have been free.

The punch card machines were under lease at all but four of the installations we visited. The Military Airlift Command was leasing 240 of the old IBM machines for about $230,000 annually. The Naval Undersea Warfare Engineering Station in Keyport, Washington, had leased an IBM keypunch for 23 years and was spending enough in monthly rental to exercise the purchase option every 10 months. In both instances, the installations could have obtained many of the same items from GSA at minimal or no cost, yet they had renewed their rental contracts through fiscal year 1983.

At the same time these rental contracts were being renewed for fiscal year 1983, GSA was sending excess machines to organizations outside the government. GSA listed 59 "best condition guaranteed" IBM keypunch machines in its September 8, 1982, excess listing. GSA informed us that 17 of these machines were picked up by the U.S. Information Agency for foreign aid distribution. Thirty-six machines were unclaimed and, thus, were processed for disposal and sale outside the government. Only six machines were requested for use by federal agencies.

LACK OF INFORMATION AND ANALYSIS RESULTED IN MISSED OPPORTUNITIES

Data processing managers at the installations we visited had not identified or pursued the various refinancing alternatives open to them because they lacked the specific management procedures and monetary control policies essential to such operations. Managers were not analyzing their installed equipment leases before yearly renewal, and they were not maintaining the data necessary to perform such analyses. Without requirements to become more economical, these managers were reluctant to change traditional lease arrangements. Consequently, most found it easier to simply renew existing leases.

Analysis of leasing alternatives was not performed, and the data necessary to do so was lacking

At the agencies we visited, we seldom found economic analyses for renewal of equipment leases. Federal data processing managers are required to perform lease versus buy analyses before acquiring new ADP equipment to demonstrate that the selected acquisition method results in the lowest overall cost. They are not, however, required to continually and systematically analyze their installed equipment leases for cost-effective alternatives. Federal Property Management Regulations required such analyses until 1981. However, GSA deleted this requirement from the regulations in January 1981 in response to the Administration's initiatives to reduce agencies' regulatory and paperwork burden.

Nine of the installations we visited did not prepare recurring economic analyses on their installed, leased equipment. Two of these--the San Antonio Data Services Center and the National Institutes of Health--consciously invoked a "lease only" acquisition practice, and management officials informed us that this made the suggestion of analyses moot. The two installations that did periodically analyze lease renewal economics relied on vendor-provided data (e.g., accumulated purchase option credits) that could not be independently verified.

Moreover, if data processing managers had attempted to analyze their equipment inventories, then they would have found it difficult or impossible, because the necessary data had not been maintained. For example, none of the installations we visited tracked the government's accumulated purchase option credits; accounting records needed to accurately reconstruct credit information on equipment more than 5 years old were not retained. In three instances, the installations did not have records of contract terms and conditions.

Further, at most installations information maintained for inventory purposes was inaccurate. We found errors in equipment

inventory records at all but two of the installations, including discrepancies in recorded model numbers, serial numbers, purchase prices, rental rates, and installation dates. For example, on the inventory maintained at the Naval Undersea Warfare Engineering Station, we discovered inaccurate monthly rental amounts and incorrect installation dates.

Agencies have missed savings opportunities by not monitoring leases

The departments and agencies we reviewed have incurred unnecessary costs or have lost opportunities to save because they did not maintain essential equipment data or monitor contract terms and conditions. For example, the Center Automation Management Office for the Training and Doctrine Command Schools at Fort Lee, Virginia, has not only unnecessarily paid rent on a component it could have owned, but it would also now have to spend extra money to buy the piece of equipment.

The management office began leasing a memory component in October 1979 under an Ampex mandatory requirements contract originally awarded by GSA in 1977. The contract allowed that for some items, including the memory component, 77 percent of a user's monthly rental payments would accrue as purchase option credits capable of offsetting up to 100 percent of the purchase price until the 18th month of rental. If a lessee did not exercise the purchase option by the end of the 18th month, the credits were to be retroactively reduced to 25 percent of all payments, not to exceed 25 percent of the purchase price.

By March 1981, the 18th month of rental, the management office had accrued $11,088 in purchase option credits against the $11,000 component. It needed only to exercise its purchase option with Ampex and it would have owned the memory component. The office continued lease payments, however, allowing the credits to decrease. Since then, the management office has paid $12,960 in unnecessary rent, and it would now have to pay an additional $8,250 to buy the component.

We also observed that, as a result of not monitoring their contracts, agencies may have paid rent on terminals they owned. In November 1982, GSA's Fort Worth, Texas, audit office reviewed a Texas Instruments, Inc., schedule contract to assess whether price reduction provisions of the contract were followed and whether billings to federal agencies had been accurate. This multiple-award ADP schedule contract covered the period April 1, 1979, through March 31, 1980. It provided for rental, purchase, maintenance, and repair of electronic terminals. According to contract provisions, federal agencies were to accrue purchase option credits on rented equipment. The agencies also could obtain title without further monetary consideration when rental payments exceeded a certain percentage of the purchase price--150 percent for equipment installed

between January 1, 1974, and March 31, 1977, and 180 percent for items installed between March 31, 1977, and April 1, 1980.

GSA auditors found that 180 of the 214 terminals being rented then were eligible for title transfer. In fact, many had been eligible for several years. As a result of this review, GSA exercised the title transfer on all eligible terminals in January 1983, saving the government approximately $150,000 in rental payments for 1983. In addition, approximately 700 terminals have been converted to purchase or returned to Texas Instruments since 1980. Some of these units may also have been eligible for title transfer at no cost.

CONGRESSIONAL ACTIONS

In June 1983 testimony before the Subcommittee on Defense, House Committee on Appropriations, we cited several examples in which DOD installations were incurring excessive leasing costs. We also pointed out that managers at these installations were not maintaining accurate inventory records and were not systematically evaluating alternatives to reduce their lease costs. As a result, in passing the Defense Appropriation Act of 1984 (which was signed into law by the President on December 8, 1983), the Congress directed DOD to, among other things,

--purchase all ADP equipment unless DOD officials could justify another lower cost financing arrangement;

--perform an audit to (a) ensure that DOD was not continuing to pay rent on equipment already owned, (b) determine accrued purchase option credits on existing leased systems, and (c) develop an accurate inventory of ADP equipment; and

--develop a program for the economic buy out of existing ADP equipment currently leased by DOD and submit to the Congress by April 1, 1984, an action plan, with funding requirements, for implementing the program.

The Congress estimated that, by taking these actions, DOD could reduce its ADP leasing costs by $150 million in fiscal year 1984 alone; thus, the Congress reduced DOD's 1984 appropriation by that amount. Recognizing that procurement funds would be needed to begin a program of buying out uneconomical leases, the Congress added a special one-time appropriation of $150 million to the Defense Industrial Fund. As these funds are used to buy out uneconomical leases, DOD may replenish it by an annual portion of the purchase value of the ADP equipment. The Congress expects that DOD will also request additional funding as part of the action plan to accelerate the buy out of uneconomical leases.

On January 16, 1984, the Principal Deputy Assistant Secretary for Defense (Comptroller) notified the Secretaries of the Military

Departments and Directors of Defense Agencies of the action taken by the Congress and established preliminary guidelines to implement this mandate. Each DOD department or agency was directed, among other things, to:

--Purchase ADP equipment unless another approach could be justified on the basis of lowest overall cost. This policy became effective January 31, 1984.

--Plan on replacing within 2 years any leased ADP equipment that is obsolete, rather than purchasing such equipment, and identifying the necessary resources in the Five Year Defense Program.

--Develop an up-to-date, accurate inventory of ADP equipment with special emphasis on leased equipment and accrued purchase credits by March 1, 1984.

In an April 1, 1984, letter to the Congress, the Assistant Secretary of Defense (Comptroller) described DOD's action plan and funding requirements for implementing the program. The Assistant Secretary noted:

> ". . . we anticipate purchasing approximately $476 million worth of already leased ADP equipment. This action will yield net life cycle cost avoidances of nearly $1 billion in fiscal years 1984 and 1985 and $1.24 billion by fiscal year 1988."

By taking these actions, DOD expects to convert 45 percent of its existing leases to purchase within 5 years.

CONCLUSIONS

The Federal agencies we reviewed were not financing the acquisition of computer hardware in the most economical way possible. These agencies should avail themselves of the opportunity to save substantial funds by switching from current leasing arrangements to less costly alternatives. Recent DOD initiatives indicate that savings from so doing can be substantial.

To make best use of these alternatives, however, the agencies must improve their financial and records management so they will have the funds and information necessary to choose the best lease/purchase plan at the proper time.

RECOMMENDATIONS

We recommend that the Administrator of General Services issue regulations requiring all agencies to perform routine, periodic analyses of computer leases; compare the costs of available refinancing alternatives; and select the most reasonable, cost-effective alternative.

To ensure that federal departments and agencies take maximum practical advantage of available refinancing alternatives, we recommend that the heads of federal civilian agencies with substantial leasing volume (see table on p. 1) require data processing managers to

--conduct a cost-effectiveness analysis of all existing leases and develop a plan to employ, where appropriate, the refinancing alternatives described in this report and

--correct computer equipment inventory and accounting records and maintain them accurately to enable the recurring analysis of computer leases.

We further recommend that the Director of OMB require agency heads to confirm, with each annual budget submission, that all their computer leases have been evaluated for cost-effectiveness, and that such leases have been contracted at the most reasonable cost alternative available to the government.

AGENCY COMMENTS AND OUR EVALUATION

We requested written comments on a draft of this report from OMB, GSA, DOD, and the Departments of Health and Human Services, Energy, the Treasury, Agriculture, and the Interior. OMB responded orally and the Department of the Treasury had no comments. These agencies' major points are addressed below. Other comments and our responses are contained in appendices III through VIII.

OMB, GSA, and the departments agreed on the need to periodically analyze leases. Health and Human Services stated that it had initiated corrective actions. GSA disagreed, however, with our recommendation that it issue regulations requiring agencies to perform routine, periodic economic analyses of computer leases and to act upon the results. Also, GSA concluded that our overall approach to computer financing did not strike a proper balance between economy and management considerations, such as obsolescence, and that we ignored fundamental market realities. In addition, the Department of Energy disagreed (and DOD partially disagreed) with our recommendation that OMB require a budget certification to the cost-effectiveness of agency computer leases.

GSA stated that the Fixed Price Option Clause (in lease contracts) requires agencies to test the marketplace to determine whether exercising an annual renewal option is still the most advantageous method of fulfilling the government's need. GSA also noted that, as of October 1, 1983, agencies are required to summarize lease renewals in the Commerce Business Daily.

We believe the need for a specific regulatory requirement that agencies perform routine, periodic economic analyses is not obviated by the criteria cited by GSA. A requirement to "test the

marketplace" does not connote the rigor or the detail we found needed for management to make informed cost/benefit choices. The Fixed Price Option Clause does not require a review of all available options, nor does it require that managers look beyond the current year to determine realistic expectations for the life of the equipment. Moreover, our experience has clearly shown that, even with the long-standing existence of the Fixed Price Option Clause, managers were not performing economic analyses on existing leases.

The recent requirement to summarize pending lease renewals in the Commerce Business Daily is, in our opinion, one step toward lowering prices through increased competition. However, we do not see this single step as an end in itself. We believe agency data processing managers have a responsibility to specifically determine that their resources are being managed to the government's best advantage. We believe prudent managers should identify and actively seek lower cost alternatives to current leases, not simply publish their intention to renew an existing lease and then wait for the possibility that another vendor may respond with a lower offer.

We disagree with GSA's conclusion that the draft report "favors obsolescence and focuses on theoretical cost savings." As early as 1980, we stated our concern over the growing obsolescence of federal computer systems[1], and this report makes no exception to that stance. In fact, in this report, we specifically state that key factors in management's decisionmaking must be both the system's intended life and changing technology. However, we also recognize that the federal computer acquisition cycle is lengthy and that federal agencies consistently retain equipment, whether leased or not, for long periods of time. Given this condition, we believe that managers should seek the most economic acquisition alternative available to them. We do not at all advocate retaining existing equipment longer than operationally necessary.

We agree that cost savings are always "theoretical" until they are actually achieved. However, as discussed on pages 14 and 15, we would point to DOD's experience in reviewing and acting upon its uneconomical computer leases as a clear validation of the magnitude of achievable savings.

GSA's assertion that the report ignores fundamental market realities is unfounded. It asserts the report ignores that (a) greater savings can be achieved earlier in the product life cycle; (b) procurement funds are difficult to obtain; (c) the acquisition cycle is long and often painful; and (d) the biggest

---

[1]See: Continued Use of Costly, Outmoded Computers in Federal Agencies Can Be Avoided (AFMD 81-92, Dec. 15, 1980).

procurement problem is obtaining current technology. It is axiomatic that an early purchase decision will result in greater savings than will the same decision later in the life cycle of a system or component. It is also widely accepted that government agencies face a continuing battle against technological obsolescence in a procurement environment characterized by limited funding and lengthy processes. We acknowledge and agree with GSA's restatement of both of these facts. GSA's comments, nevertheless, do not address the central issues of this report: there is equipment currently leased by government agencies, which clearly intend to retain it, and there is a variety of alternatives available for doing so at less cost.

GSA says agencies should buy early in the life cycle. We agree, but the fact is, in a number of instances, agencies have not done so. This report acknowledges this and points out that there are still savings that can and should be achieved.

GSA says that there is a general lack of capital acquisition funds. We agree, which is why this report recommends a range of cost saving alternatives, of which purchase is only one. The GSA comment also underscores the importance of our recommendations in chapter 3 for increasing the capital in the ADP Fund and allowing its wider use for purchase opportunities as one method of countering this situation.

GSA points out that the acquisition cycle is long and painful, but it does not recognize the fact that this report deals only with installed equipment which has already been through the acquisition cycle. The cycle for employing any of the alternatives we describe need not be either long or painful because the equipment is already justified, installed, and functioning, and the alternatives we have described generally center around exercising existing contract options.

GSA raises the question of technological obsolescence but does not recognize that once an agency has made a conscious decision to keep a piece of equipment for a specified period of time, as managers had done in the examples we cited, the question of technology becomes moot. Once management accepts its current technology for a period of time, whether for 3 months or 3 years, its concern must shift to retaining that technology in a cost-effective manner which serves the best interests of the government and the taxpayer.

Finally, GSA states that we have addressed "the easy side of the equation," implying that we are not dealing with significant issues in government computer procurement. We agree that problems such as technical obsolescence and procurement cycle timing are significant and more difficult to address. The very fact that the solutions to the problems we are reporting are relatively easy

makes it an even greater concern to us that agencies, such as GSA, have not taken the actions necessary to correct these problems.

The Department of Energy disagreed with our recommendation to OMB that agency heads certify with each annual budget submission that computer leases have been evaluated and contracted for in a cost-effective manner. Energy agreed with the need for agencies to analyze periodically the cost-effectiveness of their computer leases, but it commented, "Periodic audits by GAO and agency Inspector General teams should be used to verify that appropriate evaluations are being conducted and documented." We do not agree with this opinion. We believe that such audits should supplement, not replace, routine oversight within the Executive Branch. OMB agreed with this recommendation, and we believe it is both reasonable and proper for such a certification to occur through the budget process.

OMB officials, however, expressed concern that our use of the term "most reasonable cost alternative" might be interpreted as "least cost" and hence "purchase" since purchase is generally the lowest cost alternative. We used the term "most reasonable cost alternative" specifically to recognize that the least cost alternative may not be the most reasonable. This is particularly true when management considers the "purchase alternative" because other factors (see p. 8) may cause management to decide that continued leasing is necessary. Under such circumstances, the "most reasonable cost alternative" could be any of the refinancing alternatives that allow an agency to continue to lease but at less cost than the current lease.

DOD disagreed with the use of the word "certify" in this recommendation. DOD agrees, as do the other departments, with the need to periodically evaluate computer leases. DOD also agrees with the concept of having agency heads ensure, with each budget submission, that such reviews have been completed. However, DOD believes that, to "certify" leases, agency heads must have "sure and certain knowledge" of each ADP component within the department or agency.

We did not intend to imply the same strict interpretation as DOD to the word "certify." We, therefore, have reworded the recommendation to say "confirm."

Finally, DOD agreed with our recommendations that agencies reevaluate all existing leases for possible refinancing and correcting inventory records. However, DOD requested that it be excluded from coverage of these recommendations because it has already complied with congressional guidance requiring the same actions. We concur and have modified the recommendation on analyzing current leases to specify civil agencies. Notwithstanding these actions, DOD will continue to have sizable leasing expenditures for the immediate future and we believe that, in routinely evaluating them, DOD should consider all available refinancing options.

CHAPTER 3

OMB AND GSA CAN DO MORE TO ASSIST AGENCIES IN IMPROVING LEASING PRACTICES

While agencies can do much to improve their management of leased equipment, we believe GSA and OMB must provide more leadership and support so that agency efforts produce the cost savings that are clearly available. We found that GSA has not developed the accurate governmentwide computer equipment data base necessary to provide for the economical acquisition of computer equipment. In addition, GSA and OMB have not provided agencies the funding support for unbudgeted purchase opportunities envisioned by the Brooks Act for the ADP Fund.

GSA IS RESPONSIBLE FOR ADP ACQUISITION LEADERSHIP

The Brooks Act authorized and directed the Administrator of General Services to coordinate and provide for the economic and efficient purchase, lease, and maintenance of computer equipment by federal agencies. The act also required the establishment of a management information system containing computer inventory and financial data. This system, which is operated by GSA, is referred to as the Automatic Data Processing Management Information System (ADP-MIS).[1] The act also directed GSA to administer an ADP fund for the acquisition of agency equipment requirements.

OMB Circular A-71, which identified agency administrative and management responsibilities for ADP, elaborated on this charter by stating that GSA should aid in achieving cost-effective selection, acquisition, and use of ADP equipment by

--providing Federal Schedules of Supply (Schedule Contracts) for agency use at the start of each year and seeking improvements in their terms, conditions, and pricing;

--providing overall coordination and leadership for the reuse of excess-owned and excess-leased equipment and the disposal of economically obsolete equipment; and

--cooperating in the continuous refinement and improvement of management information systems relating to ADP activities.

---

[1]GSA Temporary Regulation F-500, effective Oct. 1, 1983, renamed the ADP-MIS as the ADPE Data System.

GSA NEEDS BETTER INFORMATION TO HELP AGENCIES REDUCE COMPUTER LEASING COSTS

The Brooks Act intended the ADP-MIS to provide an inventory and financial management data base to help such agencies as GSA and OMB carry out their specific governmentwide responsibilities and to help all agencies manage their ADP resources. An accurate data base is a key to effectively providing the information needed to (1) assess and negotiate schedule contract provisions and (2) place excess equipment where it will generate the greatest savings to the government. These goals are not being met because the present ADP-MIS contains inaccurate and outdated data. It also does not contain the data elements necessary for performing economic analyses of proposed contract provisions and various refinancing alternatives.

The ADP-MIS was implemented in April 196.. GSA specifies the data elements to be collected from agencies and how frequently agencies will report. All federal agencies that use or plan to use ADP equipment or services are required to furnish accurate and timely data to GSA. The system is used to publish an annual inventory of ADP equipment in the U.S. Government. Federal agencies, as well as the Congress and the public, can request data from the system.

Until October 1, 1983, agencies were required to report 37 data elements on each item, including specific information on location, maintenance, and capacity utilization. On October 1, 1983, GSA reduced the required number of data elements to make reporting easier for the agencies and thereby increase the accuracy of submitted data. Now only 13 data elements are required, including the item number, manufacturer, system identification, purchase or monthly rental cost, type of ownership, acquisition date and the year the system's life is expected to end. Agencies are no longer required to report terminals, punch card equipment, owned systems costing $50,000 or less and leased systems renting for less than $1,668 per month.

We cannot say whether this streamlined reporting system will increase data accuracy; however, the revised reporting requirements do not include key financial and contractual data elements necessary to analyze equipment acquisition economies. Specifically, the requirements do not call for information on accrued purchase option credits and type of contract.

Information in the ADP-MIS is inaccurate and has been for some time

Data in the ADP-MIS is inaccurate and has been recognized as such for several years. In a 1975 report on implementation of the Brooks Act, we reported that the ADP-MIS was useful for overall trend analysis but, because of inaccuracies, it was not adequate

for detailed analysis. In its April 1983 summary of major ADP and telecommunications acquisition plans for federal agencies, OMB stated that the ADP inventory had not always reflected the latest acquisitions of federal government computer equipment, nor had data already in the inventory been as accurate as possible. OMB cited as evidence its analysis of the true status of 810 computers shown in the inventory acquired before 1966--the data was correct for only 18.

We attempted to use the ADP-MIS to select sites for this review but could not do so because of inaccuracies in the data base. We found errors in the equipment listings for six of eight installations we initially contacted. For example, three of these sites had equipment listed on the ADP-MIS that was not installed at the facility. In two such instances, officials questioned whether the components listed on the ADP-MIS had ever been installed at the site. Officials at all three sites were unable to answer our inquiries about the disposition of these components.

Our discussions with agency computer managers revealed that they see little value in keeping the ADP-MIS up-to-date because they do not use it and they do not know how the data is used by their top agency management. Managers told us they maintain data to fulfill ADP-MIS reporting requirements separate from the information maintained to manage agency leases. We found that timely updating of the ADP-MIS data was not a priority for the installation computer manager. For example, the manager of one Department of Agriculture headquarters component, the Agricultural Research Service, told us his office had not updated the MIS since 1979. When we visited the Bureau of Land Management's Denver Service Center, we found that it had not updated its input to the Department of the Interior in 14 months.

The GSA ADP-MIS manager stated that federal agencies have made little use of the inventory data bank. He estimated that only 12 reports were issued to agencies in the last year. He and other GSA officials told us equipment vendors and researchers were the primary users of the data. Within GSA, we found that little use is made of the ADP-MIS because GSA managers recognize the information it contains is inaccurate. The GSA ADP-MIS manager told us that GSA does not use the data for operational decisions. However, GSA does use the ADP-MIS to report to the public and to the Congress on governmentwide ADP activity.

Negotiating and analyzing schedule contracts

Without an up-to-date data base of information on government computer components leased off the schedule contracts, GSA negotiators are hampered in developing a negotiation strategy that adequately considers the cost impact of proposed changes in price and contract terms on already installed components. GSA's policy and

negotiation strategy is to award contracts to firms offering a price equal to or better than that available to large volume commercial customers under similar conditions and terms. Negotiators make these pricing decisions on the basis of commercial data submitted by the offerors. However, contract negotiators do not use data on types and volumes of equipment already being leased under schedule contracts when developing negotiation strategies.

The value of having this information can be illustrated by certain changes negotiated between the fiscal year 1982 and 1983 IBM schedule contracts. The fiscal 1982 contract included a provision that allowed for additional purchase option credit accruals on 300 IBM equipment models installed for 24 months or longer. This provision was omitted, however, from the fiscal 1983 contract when a federal lease-to-ownership plan was added. The negotiator made no analysis to estimate the relative effect of those changes on equipment currently being leased. An essential element of this analysis would have been the changes in the earned purchase option credits and their effect on net purchase prices.

Because GSA lacked information on accumulated purchase option credits, neither we nor GSA could perform such an analysis. However, we did examine data for three of the equipment models the National Institutes of Health had been leasing in multiple quantities under the fiscal 1982 IBM contract. The Institutes had been leasing 30 units of these three models long enough to qualify for the additional credit accruals available. While the gross purchase price for these items was reduced in the fiscal 1983 contract, eliminating the special credit accruals increased the net purchase price by $103,730, as shown below.

Contract year (Purchase Date)	Gross purchase price	Accrued purchase credits		Net price
FY 1982 (9/30/82)	$728,938	$405,660	=	$323,278
FY 1983 (10/1/82)	$696,228	$269,220	=	$427,008
Reduction in gross purchase price:	$ 32,710			
Credits lost:		$136,440		
Net price increase				$103,730

In analyzing the loss of credits, we observed that the Institutes could have also acquired the equipment under provisions of the fiscal year 1983 federal-lease-to-ownership plan. However, the net purchase price would still have increased by about $36,000 over the fiscal 1982 purchase prices.

If GSA had this information, the contract negotiator would have been able to identify how many of the 300 models were being leased, determine the credits that would be lost, and estimate changes in net purchase prices. The Chief of GSA's Schedule Contract Division told us GSA did not have the data necessary to perform such analyses, and it would have had to make a special request of the equipment manufacturer to obtain the data. He said that GSA had not requested this information from IBM and would have had no means of verifying it. We do not know whether this information would have enabled GSA to negotiate different terms and pricing. However, we believe such information is necessary to ensure that GSA is obtaining the best possible pricing and terms for the government.

Transferring credits on excess leased equipment

The GSA Excess Equipment Branch needs accurate information on lease types and accrued purchase option credits to identify potential users for reported excess equipment, particularly leased equipment with substantial accrued credits. Agencies seeking to obtain such equipment must do so before the contract release date to avoid losing credits. With accurate data in the ADP-MIS, GSA could identify reuse opportunities and alert potential users, instead of relying on agencies to find the item on GSA's excess availability list. In identifying these opportunities, GSA could target the ones showing the maximum economic advantage to the government and work to arrange a transfer of credits between machines so that the fewest credits are lost.

Agencies are to provide GSA at least 90 days' notice when owned or leased equipment will be disposed so that GSA can locate another agency user. The objective is to retain government-owned equipment and equipment with greater accrued credits by substituting such excess equipment for identical equipment leased by another agency. While in some cases this may require physical transfer of machines, in others, a paper transfer of the credits can be made so that the machine with fewer accrued credits would be the one recorded as returned to the manufacturer.

GSA officials responsible for processing excess equipment told us that they did not know to what extent agencies could improve their accrued credit position by acquiring excess leased equipment. However, they did acknowledge that many leased items were not acquired by other agencies, and the accrued credits were returned to the manufacturer. GSA furnished us data showing that accrued credits were returned to the manufacturer for 91 of 96 items reported from October 1, 1982, to May 9, 1983. GSA could identify the credits returned for 57 of the 91 items; the amount exceeded $5 million.

These GSA officials also told us that credits were lost because agencies frequently reported too late, sometimes even after

the equipment had been returned to the manufacturer. However, they acknowledged that they made no effort to identify potential users for the excess equipment and had no means available for doing so. Instead, GSA's procedure is to advertise the equipment in its biweekly excess availability list. Agencies are expected to search the list to find equipment they can use and notify GSA to arrange a transfer.

The manager of the Excess Equipment Program said that the ADP-MIS was inadequate for identifying potential transfers because it was inaccurate and contained no information on accrued credits. At best, he said, the ADP-MIS identified agencies leasing the same piece of equipment, but even this information was not up-to-date. We believe that GSA needs a mechanism for obtaining timely information on accrued purchase option credits and contract type for leased equipment. Using this information, GSA would be able to determine if the government was leasing an item that had fewer credits than one that an agency was giving up.

GSA NEEDS TO PROVIDE INFORMATION TO AGENCIES ON THE THIRD-PARTY MARKET

We found that GSA has done little to ensure that agency data processing managers know about the third-party computer market and its practices and pricing trends. Without GSA guidance, many of the federal data processing managers and agency officials were reluctant to obtain computer equipment and related services from other than the original manufacturer, despite the potential for significant savings. Some were reluctant because of uncertainty about how a sell/leaseback could be completed cost effectively. Others feared a possible resulting decline in maintenance service. We also found, through our survey of third-party computer dealers and lessors, that they have not been aggressive in pursuing federal business because of provisions regarding early lease cancellation and problems with fiscal year funding. Notwithstanding these concerns, over a third of the third-party firms are ready and willing to do business if they can charge federal agencies premium prices.

It was clear that GSA had provided the agencies little information and guidance on the third-party market. This lack of involvement by GSA translated into reluctance on the part of agency data processing managers to become involved in third-party transactions and a lack of knowledge about how to successfully complete such transactions. At each installation visited, we asked managers if they had (1) obtained computer equipment from third-party firms and/or (2) considered or participated in a sell/leaseback transaction. While some managers had acquired peripheral items, such as keypunch equipment or terminals, from third parties, they had not been involved in major transactions or sell/leasebacks. In fact, we found that managers and officials were uncertain about how to transact a sell/leaseback cost effectively under existing procurement guidelines.

In addition, some of these officials and other managers said they feared major equipment manufacturers would not provide quality maintenance under third-party arrangements. A manager at the Naval Regional Data Automation Center in Pensacola, Florida, asserted that, if one company provided the lease and another provided the maintenance, twice as much effort would be required to maintain control of equipment and monitor contracts. We discussed these perceptions with non-federal managers who had actual experience with third-party transactions and were told that such concerns, although widely held, were largely unfounded.

Another reason why third-party contracts have not been used extensively concerns the industry itself. Consisting of mostly small companies, this multi-billion dollar industry has not generally been aggressive in pursuing federal business. Our survey of 89 third-party dealers and lessors indicated a majority were unwilling to assume the risks they perceived in doing business with the federal government. The computer dealers we contacted were most concerned about contract provisions that allow early cancellation of a lease, for the government's convenience, with as little as 30 days' notice without monetary penalty. The dealers believe this practice unfairly places the full burden of monetary risk on them and is inconsistent with common commercial business practice. Some reluctance is also based on these firms' belief that fiscal year funding, or the inability to negotiate multi-year contracts, limits long-term commitment by federal agencies.

Consequently, several dealers said they have found the commercial market more attractive. Those who do business with the government under these circumstances point out that they charge the government a premium price to compensate for the additional risk they incur. (App. II provides a profile of third-party computer industry respondents to our questionnaire and details the industry's response to questions about federal contracting practices.)

GSA HAS NOT PROVIDED ADEQUATE FUNDING SUPPORT THROUGH THE ADP FUND

The Brooks Act established the ADP Fund, recognizing that agency budget cycles often may not provide agencies the flexibility to purchase equipment when needed. The act established the ADP Fund as a revolving fund without fiscal year limitations and directed GSA to use it for the economic and efficient purchase, lease, and maintenance of ADP equipment by federal agencies. The Fund was authorized to pay for personal services, purchases, rentals, maintenance and repair, and direct operating costs for ADP service centers, as well as other related ADP costs. The Opportunity Buy Program was established as the mechanism within the Fund for purchasing installed, leased computer equipment. Under the Opportunity Buy Program, GSA, at an agency's request, purchases equipment using capital in the ADP Fund and then leases it back to the agency. Since its inception in 1968, the ADP Fund has made opportunity buys totalling $93 million, which have resulted in savings of $153 million in lease costs. However, the program has

been virtually eliminated in the last 2 years because agencies' requests for funding have consistently been denied and discouraged.

GSA's rationale for denials has been that the capital authorized for opportunity buys was not available because it was needed for other ADP Fund programs. We found, however, that GSA could provide no analysis showing the relative economic benefit of using the Fund for these other programs.

Agency requests for opportunity buy funds require GSA approval. If requests are for $500,000 or more, OMB approval is also required. To be eligible for funding, the purchase by the Fund must result in the government spending at least 30 percent less than it would have spent if the agency had continued to lease. The agency must also convince GSA and/or OMB that the purchase could not have been made through the normal budget process and that it is the best purchase alternative available. Opportunities can occur for a variety of reasons, such as manufacturers changing product lines, pricing policies, or contract terms.

GSA decides, subject to OMB approval, how much of the ADP Fund's capital ($43.3 million as of September 30, 1982) will be used for opportunity buys. For fiscal years 1982 and 1983, OMB gave GSA approval for outlays of up to $4 and $12 million, respectively. However, GSA funded only one request during this period, a $42,643 purchase for the Navy in fiscal 1982.

The manager of the Opportunity Buy Program told us that, on the basis of formal requests and informal inquiries, she believed nearly all of the amount authorized for opportunity buys could have been used. In fiscal 1982, GSA denied four other formal requests totalling $2 million. Two of these requests met the 30-percent requirement to qualify for funding. One request for $240,069 was denied because of a temporary ban on capital outlays imposed by GSA management. OMB denied the larger request for $1,063,369 because, according to an OMB official, it appeared the agency was trying to rush approval of the purchase through the Fund to avoid OMB oversight. In fiscal 1983, three qualified requests were received totalling $5.1 million, each having a rate of return of over 40 percent. All three requests were denied because the capital budgeted for the Opportunity Buy Program was used to meet the needs of other ADP Fund programs, such as the Teleprocessing Services Program.

In addition to the denials, the manager of the Opportunity Buy Program told us she had, in phone conversations, discouraged several other agencies from applying because she knew that even if the request qualified, the ADP Fund would not have the capital available to make the purchase. Because the manager had not kept a log of phone inquiries, we could not estimate the cost of the purchases discouraged. However, from our conversations with agency computer managers and our analysis of the sample of leased equipment, we believe that if capital had been available, GSA could have easily spent the amount budgeted for opportunity buys.

From our discussions with agency computer managers, we believe that the ADP Fund is not considered a viable funding option because money is seldom available. In addition, managers said it was not worth going through the burdensome justification process. One installation manager told us that his agency had successfully used the Opportunity Buy Program in the past, but over the last 2 years GSA had always told him that money was not available. As a result, he, like other managers we spoke with, no longer tried to use the ADP Fund.

Our analysis of the components discussed in chapter 2 also shows that many candidates met the financial criteria for the ADP Opportunity Buy Program. We found that at least 100 items in our sample of 240 items met GSA's rate of return criteria for opportunity buy eligibility. However, other considerations being equal, a decision to fund these buys would have required a $1.9 million outlay from the ADP Fund. Considering that our sample is only a small fraction of the government's inventory of leased equipment, thought to exceed 90,000 items, it appears that the ADP Fund could satisfy only a small portion of the purchase opportunities currently available.

GSA officials told us the funds were not available because the fund's capital authorized for opportunity buys was needed for other programs. For example, in the Teleprocessing Services Program, each vendor providing these services to agencies submits one bill for all agencies to GSA which pays it from the Fund. GSA then bills agencies for repayment, including an amount to recover GSA's administrative expenses. Other ADP Fund programs, such as Data Processing Services Contracts and Federal Data Processing Centers, place similar cash flow requirements on the Fund because GSA uses the Fund to pay vendors or GSA employees who provide services to agencies which later reimburse the Fund.

Because the ADP Fund is a revolving fund, GSA's ability to fund opportunity buys depends, in part, on the cash flow of each program (i.e., the size of payments from the Fund by GSA and the time it takes agencies to reimburse the Fund). These other programs have tied up increasing amounts of the Fund's capital because billings to agencies have increased. At the same time, GSA has experienced difficulty in obtaining reimbursement from agencies. GSA's billings to agencies for these ADP Fund programs rose from $59 million to $140 million between fiscal years 1978 and 1982. During this time, agencies took an average of about 3 months to repay the Fund. GSA made some progress in speeding up the collections in fiscal year 1982. It stressed collecting delinquent accounts and processing more agency billings through a system that allows for bookkeeping transfer of funds between agencies and GSA instead of invoice processing. According to GSA officials, however, some agencies not under this system have again become delinquent because they are putting more emphasis on paying vendors on time than on paying other federal agencies.

GSA officials told us that the Opportunity Buy Program was difficult to justify because it ties up the Fund's capital for longer periods of time than do the other programs. Outlays from the Fund for opportunity buys can be quite large, and reimbursement can extend for 2 to 3 years compared to the 3-month average for other programs. GSA has not encouraged opportunity buys overall and has required prompt repayment from those agencies that could qualify. This reasoning notwithstanding, GSA officials responsible for the Fund could not show us that it is economically in the government's best interest to use the Fund for other fund programs while denying opportunity buy requests having a rate of return of at least 30 percent.

CONCLUSIONS

In our opinion, OMB and GSA should provide leadership to correct the uneconomical leasing of ADP equipment and ensure that it does not recur. On the basis of our study of only 240 items of equipment, we believe that the government could substantially reduce its leasing costs in a relatively short period of time by using lower cost alternatives. Steps must be taken to develop a coordinated, governmentwide program to better identify the opportunities and the funding requirements to realize them.

In passing the Brooks Act, the Congress specified two tools--a governmentwide inventory and an ADP fund--to carry out such a program. Over the years, these tools have not been employed well. As a result, today neither we nor the executive branch can give the Congress an accurate accounting of our current lease situation nor the magnitude of the opportunities that clearly exist. Sound financial management will lead to more cost-effective government, but sound financial management requires, among other things, a good inventory and accounting of lease costs and accumulated purchase option credits. Neither of these is currently available.

Furthermore, the ADP Fund, in our opinion, is not funded adequately to deal with the present situation. Even though the poor status of the inventory records prevents us from estimating the level of funds needed, we do not believe that the $12 million would be sufficient if agencies requested purchase authority in all cases where it was practical and economical to do so. In December 1983 the Congress appropriated $150 million just to begin correcting the problem in DOD and requested a more precise estimate of needed procurement funds by April 1984. DOD later reported that it needed about $476 million to buy out its uneconomical leases, but by doing so it would realize a net savings of $1.24 billion in 4 years.

Unless OMB and GSA assume a leadership role in developing and using an adequate inventory and providing agencies financial support through the ADP Fund, we believe the government will continue

to pay far more than necessary to finance its inventory of ADP equipment.

Finally, federal agencies need information on the merits and mechanics of conducting sell/leaseback transactions with the third-party industry. Also, the industry's negative perceptions about conducting business with the federal government, specifically those dealing with cancellation clauses and fiscal year funding, must be addressed. Otherwise, another competitive source for reducing the cost of financing the government's equipment needs will not be fully used.

AGENCY COMMENTS AND OUR EVALUATION

We requested written comments on our draft report from OMB, GSA, DOD, and the Departments of Health and Human Services, Energy, the Treasury, Agriculture, and the Interior. OMB provided official oral comments and the Department of the Treasury had no comments. The major points raised by these agencies are addressed below. Other comments and our responses are contained in appendices III through VIII.

OMB officials, GSA, and the departments generally agreed with our specific findings and conclusions. However, they did not agree with our suggestion that GSA collect and analyze component-level financial and contractual information to identify equipment that could be refinanced at a lower cost. OMB officials and GSA also disagreed with our suggestion to expand the use of the ADP Fund for opportunity buys.

While none of the commenting agencies disagreed with the need to collect and periodically analyze the financial and contractual data associated with leased computer hardware, each of them disagreed that the information should reside with and be analyzed by GSA. OMB officials, GSA, and the departments believed that the analysis function was an agency responsibility and suggested that GSA's maintenance and analysis of this information was unnecessarily duplicative. We find this argument persuasive.

Our intent in proposing a GSA analysis role was to ensure that GSA had ready access to adequately detailed governmentwide data to help negotiate governmentwide contracts and manage equipment reuse. We believe GSA can still achieve this objective with agency-level responsibility for data collection and analysis, provided GSA is accorded timely, ready access to summary data on an as-needed basis. We have, therefore, deleted our recommendation that GSA perform this analysis and placed the analysis function in our recommendations to agencies in chapter 2.

OMB officials commented that the overall investment priorities for the ADP Fund needed review. However, they disagreed with expanding the Fund's purchase authority. These officials reiterated

OMB's historic position that the ADP Fund should be the financing option of last resort for agencies and, as such, should be used sparingly. For this reason, OMB officials also disagreed with our suggestion to increase ADP Fund capitalization. We acknowledge that agencies have a basic responsibility to budget for their ADP needs and believe they should do so to the maximum feasible extent. But we are also concerned that the budget process for capital acquisitions cannot always respond to the rapid changes in the computer marketplace that make refinancing desirable. The ADP Fund offers the potential for such funding flexibility and, in our opinion, its expanded use for this purpose is needed to counter an immediate and costly problem.

GSA did not address our suggestion regarding the level of ADP Fund capitalization or our suggestion to expand the use of the Fund. GSA, however, disagreed with our suggestion that capital in the Fund budgeted for opportunity buys be used only for that purpose. According to GSA, such action would be undesirable because it would unduly restrict GSA management's flexibility to initiate new programs and it would weaken the financial posture of other ADP Fund programs.

We recognize that the controls we are recommending would limit GSA's flexibility in employing Fund capital. However, we continue to believe in the merits of our suggestions. We believe this report clearly demonstrates the need for both greater flexibility in using the Fund for opportunity buys and a greater level of capitalization as an investment in future savings. The availability of capital authorized for opportunity buys is a key element in achieving these savings. Moreover, as discussed on pages 26-29, GSA has not compared the relative benefits of ADP Fund programs and, therefore, is unable to present a persuasive argument either in favor of other Fund programs or in opposition to the Opportunity Buy Program. To provide GSA some flexibility in managing the ADP Fund while still ensuring that capital is available for opportunity buys, we have modified our recommendation to require GSA to seek OMB's approval to reprogram capital reserved for opportunity buys when it can justify that the capital can be used more effectively for other programs.

RECOMMENDATIONS

To ensure that the necessary leadership and governmentwide ADP management support are forthcoming, we recommend that the Administrator of General Services

--issue guidelines for agencies in seeking third-party competition and, specifically in transacting sale/leasebacks;

--identify and revise, where it will enhance competition and be otherwise appropriate, those federal contracting practices that the third-party industry believes act as major business impediments; and

--institute controls to ensure that the capital in the ADP Fund authorized for opportunity buys is available and used only for that purpose unless it can justify to OMB that capital reserved for opportunity buys can be used more effectively for other ADP Fund programs.

We also recommend that the OMB Director

--allow agencies to make greater use of the ADP Fund to purchase equipment currently leased uneconomically and

--work with GSA and other federal agencies to determine and request an appropriate level of funding in the ADP Fund to buy out uneconomical leases.

MATTERS FOR CONSIDERATION BY THE CONGRESS

When considering future requests to increase the ADP Fund for opportunity buys, the Congress should specify that the funds be used exclusively for taking advantage of cost-effective opportunities to buy equipment.

OBJECTIVES, SCOPE, AND METHODOLOGY

In May 1982, we began looking at the viability of reducing federal data processing equipment lease costs by seeking alternatives to current leasing practices. As part of this governmentwide review, we visited 11 data processing installations to collect contract and payment data on selected pieces of installed computer equipment. We gathered this data at installations within six agencies that generally represented the most substantial portion of federal leasing expenditures. Within each of these agencies, we selected one or more sites for detailed data collection work by seeking installations that provided us

--a large proportion of installed equipment under lease,

--an overall mix of major equipment manufacturers, and

--an overall mix of lease contract types.

We performed these data collection activities at each of the following sites:

Air Force

.San Antonio Data Services Center-San Antonio, Texas

.Headquarters, Military Airlift Command-Scott Air Force Base, Illinois

.Air Force Systems Command, Armament Division-Eglin Air Force Base, Florida

.Air Force Manpower and Personnel Center-Randolph Air Force Base, Texas

Navy

.Naval Undersea Warfare Engineering Station-Keyport, Washington

.Navy Regional Data Automation Center, Pensacola Naval Air Station-Pensacola, Florida

Army

Army Quartermaster Center-Fort Lee, Virginia
Training and Doctrine Command Schools-Fort Lee, Virginia

U.S. Department of Agriculture

National Finance Center; New Orleans, Louisiana

U.S. Department of Health and Human Services

National Institutes of Health; Bethesda, Maryland

U.S. Department of the Interior

Bureau of Land Management, Denver Service Center-Denver, Colorado

We also did followup work with officials at the Air Force Computer Acquisition Center-Hanscom Air Force Base, Massachusetts; the Naval Data Automation Command-Washington, D.C.; the Army Computer Systems Command-Fort Belvoir, Virginia; GSA; and the Offices of Information Resources Management of each of the above named departments.

At each data collection site, using the installation's computer inventory, we selected a judgmental sample of installed, leased computer equipment. The sample totaled 240 items, including all leased central processing units. Other components sampled represented the equipment mix, age, and contract types prevalent at the installation. We reviewed contract and accounting records for the 240 items selected. We also discussed inventory and accounting procedures, purchase option credit tracking, economic analysis, and general leasing practices with cognizant personnel at each site. When necessary, we obtained additional leasing information from intermediate and headquarters or major commands. Our review was limited to the records associated with the individual equipment items in our sample. We did not assess either the overall management or the total system of internal controls of any installation or system.

We also visited various state and local government computer installations and private firms identified to us as having applied various leasing alternatives to reduce computer hardware costs. At each of these installations and companies, we discussed with cognizant managers

--the results of specific alternatives employed,

--their motivation in seeking alternatives,

--the lessons learned in implementing alternatives, and

--suggestions for economic analyses to identify appropriate alternatives.

COST COMPARISONS FOR SELECTED COMPUTER LEASING ALTERNATIVES

We assessed the costs and benefits of current computer leases for the sample of 240 computer components by comparing the cost of continued leasing under the current contract with projected costs for each of four potential acquisition alternatives. There was at least one alternative costing less than the current lease for 174 of these components, assuming a 3-year remaining use, and 217 components, assuming a 5-year remaining use.

The sample

Our analysis included computer components leased from six major domestic computer manufacturers and several other vendors. We analyzed components leased under both agency- and GSA-negotiated contracts and GSA mandatory and non-mandatory schedule contracts, which provided for straight rental, lease-with-option-to-purchase, and lease-to-ownership conditions. The specific equipment mix and sample age is summarized in the chart below.

Vendor	Type of equipment: Processors	Storage	Communications	Input/Output	Total sample items	Percent of Sample	Average (years): Age	Remaining
IBM	7	11	8	21	47	20	3.7	3.0
Honeywell	6	17	5	16	44	18	2.0	6.2
Univac	3	13	8	14	38	16	3.0	2.1
Burroughs	2	15	4	4	25	10	4.4	2.9
Digital Equipment	6	7	1	5	19	8	1.3	2.9
Control Data	3	7	4	2	16	7	2.3	3.2
Others	8	16	1	26	51	21	2.1	3.6
TOTALS	35	86	31	88	240	100	2.7	3.3

CALCULATION RESULTS

We compared the cost of continuing the current lease on each of these components at fiscal year 1983 prices, terms, and conditions to (1) the cost of exercising the government's purchase option, (2) estimated cost for third-party lease refinancing and (3) published used computer prices for the same component, when such prices were readily available. We found that, in most cases, purchasing the equipment, refinancing the existing lease, or acquiring a used substitute would cost less than continuing the existing leases. There was no lower cost alternative to present rental contracts for 23 of the components (less than 10 percent of the 240 reviewed). Each of these 23 items fell into one of the following categories:

--Those with exceptionally low lease prices, usually obtained through negotiated long-term contracts.

--Those being retained for only a short period of time or on a trial basis.

CALCULATION METHODS

In performing our calculations, we traced the lease payments for equipment from its installation date through the end of fiscal year 1982. Then, using this payment data, we applied appropriate contract terms and conditions to calculate each component's accumulated purchase option credits and the government's potential net acquisition cost under the then-current contract. The average age of the components we reviewed was 2.7 years and the responsible installation managers told us they expected to retain them an average of 3.3 additional years. Government ADP equipment has historically been retained for even longer periods. Accordingly, we performed our specific economic analyses assuming both 3- and 5-year remaining systems lives for each component.

The contract terms, conditions, and prices for each leased component dictated the elements of each individual cost calculation, making it impractical to display the raw data and specific formulae in this report. The following narrative descriptions, however, outline our procedures for calculating each category for cost considered in our comparisons. While individual inputs for each calculations will vary, the descriptions provided should allow the reader to determine comparative costs for any individual component.

Current rent

Current rental costs for each component were calculated using the terms, conditions, and prices applicable on October 1, 1982,

for fiscal year 1983. These prices were extended for the 3- and 5-year analysis periods. Cash flows were discounted to net present value, as described on page 38.

All rents used in our calculations were net of maintenance, because maintenance must be provided regardless of the method of financing. Where rent and maintenance charges were bundled and the maintenance portion was not specified in the contract, we subtracted from the bundled charge the maintenance charges applicable for equivalent coverage under the manufacturer's fiscal year 1983 GSA schedule contract.

Purchase option

The government's purchase option exercise price was calculated by subtracting any credits accrued through September 30, 1982, from the acquisition cost in effect on October 1, 1982. Discounts and special credits were taken if applicable on October 1, 1982.

Sell/leaseback

The monthly lease cost resulting from a sell/leaseback transaction was calculated using the government's purchase option exercise price as the equipment acquisition cost and assuming 3- and 5-year lease terms.

We determined, through interviews with officials from several third-party firms and attendance at a lease structuring seminar conducted by the Computer Dealers and Lessors Association, that the use of a formula approach to structuring leases is relatively standard in the third-party industry. A lessor's sell/leaseback payment calculation would be simply summarized as the result of the following equation:

$$\frac{\text{LOAN + INTEREST + EQUITY + RETURN ON INVESTMENT*}}{\text{TERM}} = \text{MO.PMT.}$$

*RETURN ON INVESTMENT = RESIDUAL VALUE + TAX BENEFIT + CASH

Third-party lessors informed us that we could approximate this calculation by using the formula for the present value of a series of lease payments. The lessors demonstrated this simplified approach as a calculator procedure. They suggested that we use an annuity due formula with the equipment acquisition cost as the present value and a discount rated prime plus 1 or 2 percentage points as the interest expense. They also noted that we should assume that residual value would be either low or zero.

We tested the assertion that this simplified formula approach would approximate the results of more complex lease rate calculations by first calculating after-tax leaseback rates using a lease

payment structuring procedure published by Hewlett-Packard and advocated by the Computer Dealers and Lessors Association. We then used a VSBasic program to determine which compound interest rate in the simplified formula would yield an approximately equal result. We found that the results of the simplified formula approximated those of the Hewlett-Packard procedure; therefore, we used the shorter formula approach to estimate sell/leaseback transaction lease rates for leased components in our sample.

Used purchase price

A used purchase price was included in our analysis for any component in the sample if the component was advertised for sale in or the price was readily discernible from the publishers of one of three used computer price guides:

--"Computer Price Guide: The Blue Book of Used IBM Computer Prices," Computer Merchants, Inc.

--"Computer Price Watch," Computer Information Resources

--"Computer Hot Line," Hot Line, Inc.

Used component lease cost

The third-party lease rates for used components were estimated using the same lease structuring calculations established (above) for sell/leaseback rates, except that each component's used purchase price was substituted for the government's purchase option exercise price as the acquisition cost in the formula.

Present value discounting

Since most government funding requirements are met by the Treasury, we believe the Treasury's estimated cost to borrow funds is a reasonable basis for establishing the interest rate to be used in present value analyses. Therefore, the basis for the rates we used in discounting lease payment streams for this analysis was the average yield on outstanding marketable Treasury obligations issued in October 1982 with maturities comparable to the 3- and 5-year periods of our analysis.

TAX IMPLICATIONS OF SELL/LEASEBACK

A sell/leaseback transaction, as described in the context of this report, involves installed equipment presently leased by the government. The Internal Revenue Code generally precludes the titleholder of equipment used by the government from receiving an investment tax credit. Although the Internal Revenue Service would have to make a definitive ruling based on the facts and circumstances of any individual case, we believe that the third party

would not receive an investment tax credit in the sell/leaseback transaction we have described. In addition, our analysis of the effects of Accelerated Cost Recovery System depreciation leads us to believe that there is no reasonably determinable tax loss to the Treasury as a result of the change in titleholder to the equipment. Therefore, agencies contemplating sell/leaseback transactions on installed, leased equipment need not be hampered by concerns for foregone Treasury revenue as a result of the transaction.

RESULTS OF A SURVEY OF THE

THIRD-PARTY COMPUTER INDUSTRY

A federal data processing manager would need to seek competition from among third-party computer dealers and lessors to exercise several of the refinancing alternatives outlined in this report. Because federal managers have had little experience in dealing with the third-party industry, we sought to obtain descriptive information on the companies that comprise the industry and to solicit their opinions and attitudes on the federal government's computer procurement process. Our major information gathering tool was a mailout questionnaire (exhibit A).

Questionnaire design

The first 14 questions asked of each respondent to the questionnaire were designed to determine a company's age, size, degree of specialization, and several pertinent business practices. The remaining questions addressed respondents' experience with federal procurement, their willingness to do business with the federal government and their perceptions regarding several aspects of federal contracting. The factors we described as potential business barriers in question 15 were derived through discussions with various third-party companies and the Computer Dealers and Lessors Association.

Universe and response rate

The Computer Dealers and Lessors Association (CDLA) is the trade association for third-party firms. The CDLA's Executive Director informed us that the association represents approximately half of the companies in the third-party computer industry and that these member firms account for nearly 90 percent of the third-party business.

With the CDLA's assistance, we identified 182 U.S.-based companies doing business as computer dealers, lessors and/or brokers. We mailed our questionnaire to each of these firms. Ninety-seven (52 percent) of these companies responded, in some form, to our mailing, and 89 of these responses contained information adequate for analysis. After tabulating the answers from these 89 respondents, we reviewed the summary profile data with the Executive Director of the CDLA, who confirmed that, from his knowledge and experience, our response base appeared to accurately represent the make-up of companies belonging to the association.

Analysis methods

Tabulations, comparisons, and tests for significance were performed using the Statistical Package for the Social Sciences, Version X (SPSSX) a software system of computer programs commonly

used to perform such calculations. Comparisons between cross-tabulated groups of questionnaire responses were tested for significance, where appropriate, at a 95-percent confidence level.

Questionnaire results

The questionnaire responses detailed in exhibit A define our respondent group as a relatively young group of companies with 25 or fewer employees. The largest company in our respondent group reported 1982 computer-related gross revenues of $460 million, but the average company in our sample grossed $23 million in computer-related revenues in 1982 while dealing predominantly in used equipment. The 89 responding companies together accounted for more than $2 billion in computer-related business during 1982.

Thirty-seven of the companies responding to the questionnaire told us they dealt exclusively in IBM equipment--a response we had been told to expect because of IBM's predominance in the commercial marketplace. Yet, the majority of companies dealt in one or more other lines of computer equipment and there were multiple respondents for each of 18 major manufacturers we mentioned.

Thirty-six of our respondents reported that they had conducted some business with the federal government over the past 10 years. However, virtually all sought the major portion of their business from commercial sources. Only 14 of these companies reported 1982 revenues from federal sources and this tended to include federal business as only a small portion of their total business.

Overall, 42 percent of the companies in our sample said they intended to seek federal business in the near future but, among those firms that had done business with the government in the past, 39 percent were unwilling to do so again. The narrative comments that accompanied the returned questionnaires indicate that a large number of companies were unwilling to do business with the federal government because of certain risks they perceive.

The majority of respondents viewed some aspect of federal government procurement practices as major barriers to conducting business with the agencies. The practices cited most frequently were (1) requiring a contract clause allowing cancellation without penalty, (2) multi-year contracting restrictions, (3) benchmarking requirements and (4) overall complexity of federal procurement paperwork as major barriers to conducting business. Without regard to either company size or past experience with federal contracting, the responding third-party companies told us that the single biggest barrier to their willingness to do government business was contract clauses allowing cancellation for convenience. The dealers who commented to us explained that they believe this unfairly places the full burden of financial risk on them, and they pointed out that such provisions are inconsistent with common commercial business practices.

U.S. GENERAL ACCOUNTING OFFICE

Survey of the Third-Party Computer Leasing and Brokerage Industry

This questionnaire is designed to obtain descriptive information on the companies which comprise the third-party computer leasing and brokerage industry. In addition, we are interested in soliciting your opinions and attitudes on the computer procurement process of the Federal Government. This information will be used in a report to the Congress on alternative financing methods available to the Federal Government for computer hardware acquisitions.

With the assistance of the Computer Dealers and Lessors Association, we have identified computer companies who engage in third-party transactions. Each of these companies have been sent a copy of the enclosed questionnaire. The questionnaire should be completed by the company official(s) who have an overview of your company's current business operations and a basis for commenting on future directions.

Your frank and honest answers will provide valuable information. The questionnaire can be completed in about 20 to 30 minutes. Most of the questions can be completed by checking boxes or filling in blanks. The questionnaire is numbered so that when we receive your completed questionnaire, we do not have to send you a follow-up request.

Your specific answers will be used only for purposes of this study and will be held strictly confidential. In fact, your name and address will be disassociated from your questionnaire and your answers will be combined so that nobody will be able to tell how you or any other single person answered a given question. Remember, while your name is not important to this study, your experiences and opinions are. We cannot make meaningful recommendations without help and consultation from you and others like you.

Please return the completed questionnaire in the self-addressed envelope within 10 days after receipt, if possible. If you have any questions, please call either Mr. Gregory McDonald or Ms. Stephanie Rhodes in our Dallas Office at (214) 767-2020. Thank you for your cooperation.

If the self-addressed envelope is misplaced,
please mail the completed questionnaire to:

Mr. Gregory McDonald
U.S. General Accounting Office
Suite 607
1114 Commerce Street
Dallas, TX 75242

GAO NOTE: In this Exhibit, all summary data in the answer boxes are
(1) averages (i.e. means) of respondents answers for questions 1-12; and
(2) the total number of respondents responding to questions 13-19.

In order to describe the size of the industry, please provide the following information. It will be held strictly confidential.

1. In what year did your company originally start selling or leasing Automated Data Processing (ADP) equipment?

CARD1 (1)
ID1 (2-4)

YEAR: 19 75 (5-6)

2. Approximately what percentage of your company's ADP business activities are conducted as a dealer, lessor, or broker? (PERCENTAGES SHOULD TOTAL TO 100%.)

	PERCENTAGE OF ADP ACTIVITIES	
1. Dealer	41.5 %	(7-9)
2. Lessor	45.5 %	(10-12)
3. Broker	12.7 %	(13-15)
4. Other (SPECIFY)______	______%	(16-18)
	100%	

3. As of December 31, 1982, approximately how many full-time employees (including staff working on a commission basis) were on your company's payroll?

NUMBER OF FULL-TIME EMPLOYEES 11-25 (19-22)

4. Overall what was your company's approximate 1982 gross revenues from all business activities?

By gross revenues we mean that if your company bought equipment in 1982 for $100,000,000 and sold or leased it in order to realize a $6,000,000 profit, you would write $106,000.000 as your answer below. (GIVE YOUR BEST ESTIMATE.)

Overall 1982 revenues were:

$ /3 /5 /3 /2 /6 /4 /5 /5 / (23-31)

Note: for explanation of answers see note on page 1 of this exhibit.

5. Overall what was your company's approximate 1982 gross revenues from the sale, lease, and maintenance of ADP equipment and other ADP related activities? (GIVE YOUR BEST ESTIMATE.)

1982 revenues from the sale, lease and maintenance of ADP equipment were:

$ / 2 / 3 / 0 / 0 / 1 / 9 / 3 / 0 / (32-40)

6. Approximately what percentage of your company's 1982 gross revenues from ADP equipment sales, leases, and maintenance (as stated in Question 5) were derived from ADP equipment sales, leasing of ADP equipment, and maintenance of ADP equipment? (PERCENTAGES SHOULD TOTAL TO 100%.)

	PERCENTAGE OF 1982 REVENUES FROM THE SALE, LEASE, AND MAINTENANCE OF ADP EQUIPMENT	
1. ADP equipment sales	54.6 %	(41-43)
2. ADP equipment leases	43.8 %	(44-46)
3. ADP equipment maintenance	11.8 %	(47-49)
4. Other (SPECIFY) ________	%	(50-52)
	100%	

CARD2 (1)
ID2 (2-4)

7. Approximately what percentage of your company's total 1982 gross revenues from ADP equipment sales and ADP equipment leases (as stated in Question 6) were from each of the following customers? (PERCENTAGES SHOULD TOTAL TO 100%.)

	PERCENTAGE OF 1982 ADP SALES REVENUES	PERCENTAGE OF 1982 ADP LEASING REVENUES	
1. Federal Government	8.9 %	15.6 %	(5-10)
2. State/Local Government	6.3 %	7.8 %	(11-16)
3. Private, non-profit entities	9.5 %	8.5 %	(17-22)
4. Commercial companies	90.0 %	91.5 %	(23-28)
5. Other (SPECIFY) ________	%	%	(29-34)
	100%	100%	

8. Approximately what percentage of your company's 1982 gross revenues (as stated in question 5) were exclusively from sales and leases of new and used ADP equipment? (By used ADP equipment we mean ADP equipment that had been previously installed and operated for purposes other than testing.)

27.0 % NEW ADP EQUIPMENT (35-37)

75.8 % USED ADP EQUIPMENT (38-40)

Note: For explanation of answers see note on page 1 of this exhibit.

9. This question asks for information about types of transactions for new and used ADP equipment. Column A asks for information about new ADP equipment, and Column B asks for information about used ADP equipment.

A. In column A please indicate approximately what percentage of your company's 1982 new ADP equipment gross revenues were realized exclusively from the sale or lease of ADP equipment. (PERCENTAGES IN COLUMN A SHOULD TOTAL TO 100%.)

B. In column B please indicate approximately what percentage of your company's 1982 used ADP equipment gross revenues were realized exclusively from the sale or lease of ADP equipment. (PERCENTAGES IN COLUMN B SHOULD TOTAL TO 100%.)

TYPES OF TRANSACTIONS	COLUMN A PERCENT OF 1982 NEW EQUIPMENT GROSS REVENUES	COLUMN B PERCENT OF 1982 USED EQUIPMENT GROSS REVENUES	
1. ADP equipment sales	40.3 %	57.9 %	(41-46)
2. ADP equipment leases	73.0 %	46.6 %	(47-52)
	100%	100%	

10. This question asks for information about types of financing arrangements for ADP equipment. Column A asks for information about new ADP equipment, and Column B asks for information about used ADP equipment.

A. In column A please indicate approximately what percentage of your company's 1982 new ADP equipment gross revenues were realized from the following types of financing arrangements. (PERCENTAGES IN COLUMN A SHOULD TOTAL TO 100%.)

B. In column B please indicate approximately what percentage of your company's 1982 used ADP equipment gross revenues were realized from the following types of financing arrangements. (PERCENTAGES IN COLUMN B SHOULD TOTAL TO 100%.)

CARD3 (1)
ID3 (2-4)

TYPES OF FINANCING ARRANGEMENTS	COLUMN A PERCENT OF 1982 NEW EQUIPMENT GROSS REVENUES	COLUMN B PERCENT OF 1982 USED EQUIPMENT GROSS REVENUES	
1. Direct user sales	39.4 %	52.3 %	(5-10)
2. Non-payout leases	40.5 %	23.7 %	(11-16)
3. Full payout leases	37.0 %	25.3 %	(17-22)
4. Purchase/leasebacks	33.4 %	24.8 %	(23-28)
5. Other financing arrangements (SPECIFY)____	%	%	(29-34)
	100%	100%	

Note: for explanation of answers see note on page 1 of this exhibit.

11. This question asks for information about types of new and used ADP equipment. Column A asks for information about new ADP equipment, and Column B asks for information about used ADP equipment.

A. In column A please indicate approximately what percentage of your company's 1982 new ADP equipment gross revenues (exclusively from sales and leases) were realized from the following types of ADP equipment. (PERCENTAGES IN COLUMN A SHOULD TOTAL TO 100%.)

B. In column B please indicate approximately what percentage of your company's 1982 used ADP equipment gross revenues (exclusively from sales and leases) were realized from the following types of ADP equipment. (PERCENTAGES IN COLUMN B SHOULD TOTAL TO 100%.)

	COLUMN A	COLUMN B	
TYPES OF EQUIPMENT	PERCENT OF 1982 NEW EQUIPMENT GROSS REVENUES	PERCENT OF 1982 USED EQUIPMENT GROSS REVENUES	
1. Large CPU's (new cost in excess of $150,000 per unit)	37.8 %	24.0 %	(35-40)
2. Small CPU's (new cost below $150,000 per unit)	21.2 %	19.1 %	(41-46)
3. Storage devices	33.1 %	34.4 %	(47-52)
4. Communications devices	26.3 %	24.2 %	(53-58)
5. Input/output devices	19.9 %	20.3 %	(59-64)
6. Other (SPECIFY)____	%	%	(65-70)
	100%	100%	

12. In 1982, what percentage of your company's leases have the following terms? (FOR EACH LENGTH OF TERM WRITE A PERCENTAGE. PERCENTAGES SHOULD TOTAL TO 100%. IF YOUR COMPANY DOES NOT LEASE EQUIPMENT CHECK THE BOX BELOW.) CARD4 (1)

ID4 (2-4)

COMPANY DOES NOT LEASE ADP EQUIPMENT [ ] (5)

LENGTH OF TERM	PERCENTAGE OF LEASES	
1. Less than one year	12.5 %	(6-8)
2. One year	11.9 %	(9-11)
3. Two years	25.8 %	(12-14)
4. Three years	37.1 %	(15-17)
5. Four years	16.3 %	(18-20)
6. Five years	22.1 %	(21-23)
7. Over five years	6.1 %	(24-26)
8. Other (SPECIFY)____	%	(27-29)
	100%	

Note: For explanation of answers see note on page 1 of this exhibit.

13. Considering all ADP equipment leases and sales by your company in the past 3 years, have all of these transactions exclusively involved IBM equipment? (CHECK ONE BOX.)

1. [ ] Yes....SKIP TO QUESTION 15

2. [52] No.....CONTINUE TO QUESTION 14

14. For each of the following manufacturers, please check whether your company has sold or leased ADP equipment by the manufacturer recently only (January 1981 to present), in the past only (January 1981 to December 1980) or both. (FOR EACH MANUFACTURER WITH WHOM YOU HAVE EXPERIENCE, CHECK ONE COLUMN.)

(31-49)

MANUFACTURERS	RECENT ONLY (January 1981 to Present)	PAST ONLY (January 1973 to December 1980)	BOTH Recent and Past
	1	2	3
1. Amdahl	10	3	9
2. Burroughs	5	4	5
3. Control Data	6	6	14
4. Data General	2	4	3
5. Datapoint	3	1	2
6. DEC	8	2	12
7. Hewlett-Packard	6	3	6
8. Honeywell	4	4	3
9. IBM	6	0	42
10. Itel	3	6	12
11. Memorex	6	6	20
12. National Advance Systems	3	2	8
13. NCR	3	3	1
14. STC	8	2	21
15. Telex	3	7	8
16. Texas Instruments	4	1	6
17. Univac	4	4	6
18. Wang	9	0	5
19. Other (SPECIFY) ________			

Note: for explanation of answers see note on page 1 of this exhibit.

15. To what degree do you believe that the following factors are a barrier or problem for your company in conducting business with the Federal Government? (FOR EACH FACTOR CHECK ONE COLUMN.)

(50-61)

FACTORS	Little Or No Problem 1	Somewhat Of A Problem 2	Moderate Problem 3	Somewhat Of A Major Problem 4	Very Major Problem 5
1. Restrictions against multi-year contracting	7	8	13	15	44
2. Restrictions against separating bids for financing, equipment, and service	17	7	19	18	26
3. Contract clauses allowing cancellation for the convenience of the Government without penalty	0	7	6	12	63
4. Complexity of solicitation format	4	8	22	19	36
5. Complexity of proposal format	3	7	23	22	34
6. Benchmarking requirements	6	10	7	12	52
7. Elapsed time between solicitation and contract award	8	15	21	24	18
8. Amount of time required for payment by the Federal Government	8	12	25	16	24
9. Sole source procurements	20	14	13	8	30
10. Short fuse procurements	33	14	15	10	11
11. Other (SPECIFY)______					
12. Other (SPECIFY)______					

Note: for explanation of answers see note on page 1 of this exhibit.

CARDS (1)
IDS (2-4)

16. Has your company sold or leased ADP equipment to the Federal Government since 1973?

1. [36] Yes...CONTINUE TO QUESTION 17 (5)

2. [53] No....SKIP TO QUESTION 18

17. Please estimate the number of ADP sales and lease transactions your company has had with the Federal Government since January 1973.

	NUMBER OF TRANSACTIONS		
	January 1981 to Present	January 1973 to December 1980	
1. ADP equipment sales	1-10: 19 11 or more: 2	1-10: 13 11 or more: 6	(6-11)
2. ADP equipment leases	1-10: 5 11 or more: 4	1-10: 11 11 or more: 6	(12-17)

18. Does your company have specific plans to continue or start selling or leasing ADP equipment to the Federal Government sometime during the next year or two?

1. [37] Yes. (18)

2. [52] No...PLEASE LIST BELOW THE MAJOR REASON WHY YOUR FIRM DOES NOT PLAN TO DO BUSINESS WITH THE FEDERAL GOVERNMENT IN THE FUTURE. (19-20)

Note: for explanation of answers see note on page 1 of this exhibit.

19. In your opinion, to what extent (if at all) has each of the following factors influenced or contributed to the growth of the ADP leasing industry? (FOR EACH FACTOR CHECK ONE COLUMN.)

(21-28)

FACTORS	Little Or No Influence Or Factor 1	Some Influence Or Factor 2	Moderate Influence Or Factor 3	Great Influence Or Factor 4	Very Great Influence Or Factor 5
1. Savings through leases	2	2	14	15	56
2. No upfront cash outlays by the user	7	6	23	24	29
3. Technical obsolescence	3	12	33	26	14
4. Investment tax credit (ITC)	4	12	22	26	25
5. Accelerated ACRS depreciation	13	14	17	24	20
6. User familiarity with leasing	3	13	35	29	8
7. Users have funds for leasing equipment, but limited funds to purchase equipment	3	8	25	30	21
8. Other (SPECIFY)_____					

20. Please check this box [ ] if you would like to receive a copy of our report. (29)

Thank you for your cooperation.

21. In your own words please describe why your company does or does not now conduct business with the Federal Government. If wish to make any other comments, please express your views in the space below.

(30-31)

Note: For explanation of answers see note on page 1 of this exhibit.

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

AU[illegible]84

Mr. J. Dexter Peach, Director
Resources, Community, and Economic
Development Division
U. S. General Accounting Office
Washington, DC 20548

Dear Mr. Peach:

Thank you for giving us this opportunity to comment on the draft report "Effective Management of Computer Leasing Needed to Reduce Government Costs" (job code 913693). On the whole, we believe the report to be worthwhile in pointing out effective mechanisms for reducing the Goverment's ADP costs. There are, however, several areas that need to be modified.

First, your draft report recommends, in numerous places, that detailed financial and contractual information be maintained in the GSA ADP inventory (ADPE/DS) for leased equipment. As you also note, the ADP equipment inventory is inaccurate. We support the GAO recommendation to improve the equipment inventory. We do not feel that it is feasible to collect and maintain the enormous amount of data required to accurately reflect the financial and contractual condition of every piece of leased equipment in the Federal ADP inventory (your own report estimates there may be 90,000 leased items). When you consider that this information is highly volatile (the Purchase Option Credits change every month; and the GSA Schedule contracts change every year), the ability to keep this information timely is near impossible. Given the current, and proposed, cuts to the administrative functions, we see no way that this could be done without a severe burden to our bureaus. We, therefore, suggest that this recommendation be deleted and that a requirement be placed on the agencies to perform an evaluation of refinancing alternatives prior to the annual equipment lease renewals. GSA and/or OMB should assume responsibility for providing guidance and assistance in this area and for auditing the agencies' compliance.

GAO NOTE: See p. 30.

Second, on pages 14 through 15 of the draft report, you discuss and endorse the concept of reducing the agencies budgets as a method to create an incentive to find alternative refinancing methods. We believe this recommendation contradicts some of the findings and recommendations made elsewhere in your report.

GAO NOTE: **Page** numbers in this appendix have been changed to correspond to page numbers in the final report.

Specifically, on page 8 you state that "Generally, the lowest cost refinancing alternative is purchase . . . " DOI believes that most of the leased equipment that could be purchased would have a two-to-three year breakeven point (i.e. that point at which continued lease payments equals or exceeds the purchase price). Therefore, what is needed is funding two or three times higher than the current lease level in order to effect the purchase and achieve the subsequent savings.

GAO RESPONSE: On pp. 14-15 we discuss the specific actions taken by the Congress relative to DOD Computer Leasing. These actions included, but were not limited to an operations reduction. Our recommendations do not, as stated in this comment, recommend cutting agency budgets.

Finally, our Bureau of Land Management (BLM) has stated that the claim on page 22 that they have not updated their inventory records in 14 months is incorrect. BLM states it has updated its inventory records to meet the annual reporting requirements of OMB Circular A-84.

GAO RESPONSE: Our statement on p. 22 relates only to the Bureau of Land Management's Denver Service Center. When we performed our review, the Center had not updated its inventory, although Center managers informed us that they were attempting to do so.

We hope these comments will assist you in producing a final report that is both meaningful and workable.

Sincerely,

Joseph E. Doddridge

Deputy Assistant Secretary
Policy, Budget and Administration

Department of Energy
Washington, D.C. 20585

Mr. J. Dexter Peach
Director, Resources, Community and
Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

The Department of Energy (DOE) appreciates the opportunity to review and comment on the General Accounting Office (GAO) draft report entitled "Effective Management of Computer Leasing Needed to Reduce Government Costs."

DOE concurs in the GAO recommendations to Heads of Federal Agencies. Although DOE does not possess a substantial volume of leased computer equipment, the Department already has in place policies that require annual evaluation of all computer leases. In addition, the Department has used all of the various forms of acquisition recommended by GAO in their report. The Department recognizes that equipment inventory records maintained in the old GSA ADP/MIS data base were inaccurate and have been working with GSA over a period of several years to redesign and revitalize the inventory. These efforts have culminated with the new GSA ADPE/DS system which is much simpler to use and more responsive to agency needs. Once the new data base has been established it should represent a major improvement in accuracy of inventory data. DOE is committed to improving the accuracy and validity of data contained in the revised system.

The Department does not concur with the report's recommendation that GSA "collect and analyze the financial and contractual information necessary for identifying equipment that could be refinanced at less cost to the government." The responsibility for conducting such analyses should remain at the agency level. It would be significantly counter-productive to require reporting of large amounts of such data by agencies to GSA when the analyses can be more effectively conducted at a much lower echelon. The recommendation should be changed to require that such analyses be conducted by agencies. Periodic verification can be conducted when GSA conducts management reviews mandated by OMB under the Paperwork Reduction Act.

GAO NOTE: See p. 30.

The Department does not concur with the report's recommendation that OMB "require agency heads to certify with each annual budget submission that all agency computer leases have been evaluated for cost effectiveness."

The responsibility for evaluating computer leases should be left to the agencies and should be documented in Departmental acquisition case files. Periodic audits by GAO and agency Inspector General teams should be used to verify that appropriate evaluations are being conducted and documented.

GAO NOTE: See p. 19.

Sincerely,

Martha Hesse Dolan
Assistant Secretary
Management and Administration

General
Services
Administration Washington, DC 20405

SEP 5 1984

Honorable Charles A. Bowsher
Comptroller General of the
United States
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Bowsher:

Thank you for affording us the opportunity to review the draft of your proposed report entitled "Effective Management of Computer Leasing Needed To Reduce Government Costs."

Our comments to the specific recommendations of the draft report are enclosed. We believe that some important recommendations are made in the report; however, we also believe that fundamental market realities are ignored. Computers have short product life cycles. The Government tends to purchase equipment late in the product life cycle. Funds for capital investment are rarely available. Vendors provide lease to ownership plans. These inflate lease costs and automatically provide the Government with title to the equipment usually in three years after it has been depreciated by the manufacturer and when it is approaching obsolescence. Purchase for the sake of purchase is foolhardy. Purchase early in the product life cycle is good. Purchase late in the product life cycle is a waste of the taxpayers' dollars and it promotes obsolescence.

The basic objective of GSA's procurement regulations and policies is to help agencies obtain current equipment needed to meet known requirements at the lowest total overall cost. The GAO approach tends to not consider this balanced objective but instead offers an approach which favors obsolescence and focuses on theoretical cost savings (see Attachment II). We believe that the balanced approach, considering all factors including obsolescence, is the correct one.

GAO NOTE: See pp. 16-19.

Sincerely,

Ray Kline
Acting Administrator

Enclosures

RECOMMENDATIONS FOR GSA ACTION

--Establish and implement procedures for keeping its government-wide inventory up dated with accurate and timely inventory and financial information.

GSA has revised its ADP Management Information System into the ADPE/Data System (DS) effective October 1, 1983. During FY 1984, GSA has contacted each Agency to update information in the system. October 1, 1984, is the target date for data within the ADPE/DS to be accurate and up-to-date. Procedures have been developed, and are being implemented, which should assure that the accuracy and timeliness of the information is maintained.

GAO NOTE: See p. 30.

--Collect and analyze the financial and contractual information necessary for identifying equipment that could be refinanced at less cost to the government.

We believe it is the agencies' responsibility to track the accrual of purchase option credits and determine when to exercise one of the available alternatives. Since the report also recommends that Agencies certify to OMB that this has been done, GSA would only be performing a duplicative function.

GAO NOTE: See p. 30

--Promulgate regulations requiring agencies to perform routine, periodic economic analyses of computer leases and act upon the results.

Regulations are already in place. The Fixed Price Option Clause requires agencies to test the marketplace to determine whether exercising an annual renewal option is still the most advantageous method of fulfilling the Government's need. Renewal orders against ADP Schedules are required, as of October 1, 1983, to be synopsized in the Commerce Business Daily.

GAO NOTE: See pp. 16-17.

--Institute a program, beginning in fiscal year 1985, designed to routinely, and periodically analyze the government-wide ADP inventory to identify and act upon candidates for opportunity buys and the cost-effective placement of excess government-owned and government-leased equipment.

With the implementation, and enhanced maintenance, of the ADPE/DS, GSA will be able to provide more accurate and timely data to the agencies. We believe, however, that it is the agency's responsibility to scrutinize the availability listings rather than GSA doing it for them.

GAO NOTE: See p. 30.

--Issue guidelines for agencies in seeking third party competition and, specifically, in transacting sell/leasebacks.

First, we recommend that the "sell/leaseback" language be revised to clearly indicate that the transaction contemplated

is a financial transaction not a disposal of government property. This type of transaction has been carefully scrutinized by the GAO in past decisions with only certain transactions receiving GAO's approval. It would be helpful if these GAO decisions were referenced to assist agencies considering the "sell/leaseback" arrangement, i.e. 45 CG 527, 48 CG 494, 48 CG 497, 76-1 CPD 275 and 81-2 CPD 28.

GAO RESPONSE: Reference to 55 CG 1012, as the current status for sell/leaseback transactions, has been added to p. 4.

On January 19, 1984, GSA issued a letter (see enclosure) to the Senior ADP officials of all agencies advising them of a GSA program for the leaseback of ADP and Word Processing equipment (the same letter was sent to the ADP vendors). Only 2 of the 19 agencies which chose to respond expressed interest in the program. We have held discussions with those two agencies, and others identified by vendors, to try and identify appropriate leaseback situations. Once we have tried the process and have it working smoothly, appropriate guidance will be issued to agencies for their own use.

GAO RESPONSE: Our discussions with agency data processing managers indicated a reluctance to change from traditional leasing methods (see p. 12). We believe this GSA initiative is an appropriate first step in making agency managers more comfortable with non-traditional leasing methods.

--Work with the third party industry to clearly identify and improve, where possible, those federal contracting practices that act as major business impediments.

Prior to approaching agencies and vendors concerning our leaseback program, we sought comments from and discussed problems with the industry. Based on these comments, we do not intend to incorporate a 30 day no cost cancellation provision in any refinancing instruments. The standard Termination of Convenience provision will be included. In addition, we have supported proposed legislation for multi-year contracting for ADP. Lastly, GSA is formulating clearer guidance on plug-to-plug replacement procurements. We believe these actions will result in a greater usage of available financing alternatives.

--Institute controls to ensure that the capital in the ADP fund ear-marked for opportunity buys is available and used only for that purpose.

The draft report implies that GSA and OMB designated $4 million in FY 1982 and $12 million in FY 1983 to be used for opportunity buys. These figures were actually upper limitations placed upon capital expenditures for all Programs within the ADP Fund and were intended as ceilings, not targets.

The recommended restriction of capital is not a desirable management technique for two reasons:

(1) The ADP Fund capital level is such that segregation of cash for any one program would seriously jeopardize the financial posture of the remaining Programs, and

(2) Any concrete restriction placed upon ADP Fund capital would undermine GSA management's flexibility to initiate new programs within the fund or to effect necessary changes to existing programs.

GAO NOTE: See p. 31.

The theoretical savings outlined by GAO through conversion of leased to purchased equipment miss several key points:

1. If the Government buys equipment, it should buy it early in the product life cycle when true savings occur.

2. There are many reasons for a general lack of capital investment funds to permit the Government to make timely purchases.

3. The acquisition cycle is long and often painful and investment funds are rarely available. As a result, the best course of action open to agency managers is to lease equipment and to roll over rental dollars as new equipment becomes available.

4. The biggest problem the Government agencies have had in computer acquisitions is to obtain current technology to meet the needs of agencies. We have never had a problem demonstrating cost savings from acquisitions. The draft report addresses the easy side of the equation.

GAO NOTE: See pp. 16-19.

General Services Administration
Office of Information Resources Management
Washington, DC 20405

JAN 13 1984

Dear

In our continuing efforts to lower the acquisition costs of Automatic Data Processing Equipment (ADPE) and Word Processing Equipment (WP), the General Services Administration (GSA) is initiating a pilot leaseback program for installed and leased ADPE and WP. The leaseback concept is to transfer to third parties the purchase option credits earned by the Government, and lease the equipment back from them. Such arrangements may be established with various firms, including financial institutions. The program should result in a reduction in current lease cost and lower systems life cost. Current lessors to the Government will benefit by the cash flow generated. Award will be made to the vendor offering the lowest cost to the Government, and it will provide for lease with option to purchase or lease to purchase.

If your agency would like to participate, please advise us of your interest and any comments you may have. In this regard, a listing of your leased equipment that you consider suitable for this program is needed. The ADPE and WP should be in current production, at or near maximum purchase option credits, and have a remaining system life of at least three years. However, we may consider other equipment. The equipment may be currently leased under the ADP Schedule or under separate contracts.

We require the following information:

1. System make and model, including all peripherals.

2. Location of equipment.

3. Date(s) of installation.

4. Month rental rates, purchase price and purchase conversion price.

5. Name and telephone number of person to contact.

APPENDIX V

If the above can not be provided at this time, please notify us of your interest, and we will obtain the needed information at a later date. Reply should be sent to the ADP Schedules Branch, KESAS, General Services Administration, Washington, DC 20405. If there are any questions, please call Mr. James F. Bowdren on Area Code (202) 523-1526.

Sincerely,

HARRY FUCHIGAMI
Director, Office of
Information Resources
Procurement, OIRM

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

SEP 10 1991

Mr. Richard L. Fogel
Director, Human Resources
Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

The Secretary asked that I respond to your request for the Department's comments on your draft report "Effective Management of Computer Leasing Needed to Reduce Government Costs." The enclosed comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

We appreciate the opportunity to comment on this draft report before its publication.

Sincerely yours,

Richard P. Kusserow
Inspector General

Enclosure

COMMENTS OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES ON THE GENERAL ACCOUNTING OFFICE (GAO) DRAFT REPORT, "EFFECTIVE MANAGEMENT OF COMPUTER LEASING NEEDED TO REDUCE GOVERNMENT COSTS"

General Comments

In general, we concur with the report and its findings, and as shown below, have already initiated steps to comply with the report's recommendations.

GAO Recommendation

GAO recommends that the heads of Federal agencies with substantial leasing volume require data processing managers to:

-- evaluate all existing leases and develop a plan to employ, where appropriate, the refinancing alternatives described in this report by March 31, 1985, and

-- correct computer equipment inventory and accounting records and maintain them accurately to enable the recurring economic analysis of computer leases.

Department Comment

The Department has already taken two major steps to bring itself in line with these recommendations. As the report notes, Federal agencies have not taken advantage of lease and buy opportunities which could have reduced computer component lease costs by 25 to 70 percent. The Department of Health and Human Services (HHS) is participating with the General Services Administration's (GSA) Pilot Leaseback Program for installed and leased Automatic Data Processing and Word Processing Equipment. This activity was initiated throughout HHS on May 2, 1984 by the Assistant Secretary for Management and Budget.

In line with the second principal recommendation, the Assistant Secretary for Management and Budget had directed earlier (i.e., April 30, 1984) that all HHS' Operating Divisions provide accurate inventory data to the GSA's Automated Data Processing Equipment Data System. Accurate and timely reporting of these data will enable HHS staff to perform recurring economic analyses of computer leases.

We acknowledge that the NIH records discussed in the report were out of date and, as noted above, we are taking steps to both correct this situation and to foster a more appropriate environment for lease versus purchase decisions. However, we question the advisability of including the following statement in the report.

> ". . .and the National Institutes of Health, had 'lease only' policies that obviated any analyses." (page 12, paragraph 2)

Since NIH has no formal "lease only" policy, and does in fact pu chase some equipment, the quoted statement casts unnecessarily, a derogatory light on all NIH operations. It is recommended that the sentence be deleted. Such a deletion would have no apparent effect on either the meaning or substance of the paragraph.

GAO RESPONSE: We have changed the wording on p. 12 of the report to more accurately reflect the leasing activities at NIH as a management practice rather than a formal policy.

DEPARTMENT OF AGRICULTURE
OFFICE OF ASSISTANT SECRETARY FOR ADMINISTRATION
WASHINGTON, D.C. 20250

SEP 10 1984

Mr. J. Dexter Peach
Director, Resources Community and
Economic Development Division
General Accounting Office
441 G. Street, N.W.
Washington, D.C. 20548

Dear Mr. Peach:

The Department of Agriculture has reviewed the GAO draft report entitled "Effective Management of Computer Leasing Needed to Reduce Government Cost" and believes that the recommendations made by GAO should help save the government considerable money. However, no recognition has been given to the most significant step needed for effective management of computer leasing, the step that will have the biggest impact on reducing government leasing cost - namely requiring future procurements to offer some incentive for vendors to offer the "lease-to-ownership procurement (LTOP) option".

As mentioned on page 5 of the report, the lease-to-ownership option is "a plan whereby title transfers to the government after payment of a predetermined number of months of lease/rental, but with no agency obligation to continue to lease beyond each fiscal year." Normally the predetermined number of months of payment is set at sixty or the stated systems life, and the monthly payment is equal to (sometimes less than) the normal monthly "lease" payment. Thus, the payments (except for maintenance) stop at, or before, the end of the stated systems life and title transfers to the government. Therefore, from a practical viewpoint, if lease-to-ownership options are solicited, properly evaluated, and exercised, the problems described in the subject report never come up, because straight leasing would not be used. Since LTOP would almost always be equal to or less costly than straight lease plans, and since with LTOP the government would own the system, leasing should always be evaluated as less desirable than LTOP.

However, LTOP's are becoming less frequently offered. This is happening because while the government recognizes the desirability of ownership (thereby offering future savings) and writes reports like the subject report to obtain ownership, incentives are rarely given to the vendors to offer such a plan. Why should a vendor agree to transfer title at the end of the stated systems life, rather than just leasing the system to the government for that period and hoping for additional lease payments beyond the stated systems life? Where is the incentive? If the vendor does offer a LTOP whereby he charges slightly more than his lease plan, the LTOP is deemed more expensive over the system life than the vendor's straight lease plan and is therefore "not competitive" and is not selected.

What is necessary is a GAO/GSA recognition of the fact that there is a residual value to the government for ownership of a system. It is normally to the government's economic advantage to own (vs leasing) our computer systems. If a value for ownership is established then there is an incentive for the vendors to bid lease-to-ownership plans, and they will. But most procurement authorities and GSA do not pressure the agencies to state a residual value for ownership of the computer systems beyond the stated systems life. (Most computer managers are not going to do the work associated with estimating some future worth unless forced to, especially since leasing is the most advantageous way to go for computer managers since it gives them the greatest flexibility.)

Rather than simply assigning all the blame for poor lease management to the agencies and then trying to rectify the situation by requiring the agencies to do more frequent analyses of their lease situations; GAO/GSA should re-examine their efforts in getting the lease vs. ownership analysis started right in the first place. A more productive approach would entail GAO/GSA's requiring the agencies to pre-establish some value for residual value for owned systems. GSA has to take the lead on this issue. Proper action in this area will do more for effective management of computer leasing and reducing government costs than all the recommended actions of the subject report. Both are needed, but GAO and GSA should begin in the area in which they can, and must, take the lead, and that is in requiring that the agencies offer some incentive (residual value) to the vendors who offer lease-to-ownership plans.

GAO NOTE: This comment addresses assigning a residual value to equipment at the point of initial acquisition. This would add an additional factor to the cost/benefit analysis performed prior to acquiring a component. Doing so could affect initial acquisition decisions, but such decisions are not the subject of this report, which deals only with already installed equipment. This report assumed a "worst case" scenario of zero residual value in all of its analysis. Because equipment had already been acquired, adding a residual value would not have changed any of the decisions regarding refinancing alternatives discussed in this report; it would only have increased the government's anticipated savings figures by an amount equal to the asserted residual value.

Another observation on the subject draft report is that GAO concludes that the primary cause for agencies overlooking purchase or other alternatives to computer leasing is a "lack of information and incentive". While this may be the case in the GAO sample, USDA feels that the sample is too small to apply as broadly as GAO seeks to do. This generalization particularly does not apply to USDA Departmental Computer Centers.

GAO NOTE: We did not attempt to statistically project our sample. Because of the sample's mix of manufacturers equipment and contract types, however, we believe the sample is representative (see p. 35). Examples within the report did include USDA's National Finance Center, where we did find examples of the same lack of financial and contractual data cited at other locations.

The comptroller of the Department's Working Capital Fund (WCF) requires an annual lease-purchase analysis for every piece of equipment financed through the WCF, which encompasses all of the department's central service computers. In the Department of Agriculture's case, the primary cause for concern in lease-purchase decisions has historically been budgetary limitations on capital procurement funding, not a lack of information or incentive.

One recommendation offered in the subject report is a requirement that "Agency Heads certify with each annual budget submission that all Agency computer leases have been evaluated for cost effectiveness and that such leases have been contracted at the most reasonable cost alternative..." (see page 25). In light of the USDA budgetary limitation experience, language should be added to this requirement to the effect that "The most reasonable cost alternative within budgetary limitations has been made.

GAO RESPONSE: Our recommendation that leases be contracted "at the most reasonable cost alternative available to the government" embodies the understanding that some alternatives may, at any point in time, be precluded by budgetary limitations or other factors. However, we also feel that agencies need to aggressively pursue alternatives, to include seeking new or changed budgetary authority, where appropriate. Therefore, we have not changed the recommendation language.

An additional concern of USDA is the statement on page 22 of the subject report which indicates that this Department has not updated the ADP-MIS since 1979. Most of the Department's ADP equipment that comes under the purview of the ADP-MIS has been reported to the ADP-MIS system on an irregular basis, but definitely more recently than 1979. In fact, the general irregularity of reporting from the agencies was a contributing factor in the decision by GSA to replace the ADP-MIS.

GAO RESPONSE: Our statement on p. 22 of the report refers only to one component of agriculture, in this case, the Agricultural Research Service. We have added language to clarify this.

If there are any questions on lease-to-ownership plans, or on how the agencies might establish residual values or evaluate LTOP's, please contact Dr. Edward O. Joslin, OIRM (PED) 447-8743.

Sincerely,

JOHN J. FRANKE, Jr.
Assistant Secretary
for Administration

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

COMPTROLLER

2 4 OCT 1984

Mr. Frank C. Conahan
Director, National Security and
International Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) reply to the General Accounting Office (GAO) draft report "Effective Management of Computer Leasing Needed to Reduce Government Costs" dated August 3, 1984 (GAO Code No. 913693) (OSD Code No. 6578).

The Department concurs with the recommendations, except as set forth below.

- With respect to Recommendation No. 1 on evaluating all leases for possible refinancing and correcting the ADPE inventory, although it concurs with the intent, the DoD took action in January through April 1984 to comply with congressional guidance that required the same actions. Accordingly, the DoD requests that it be excluded from the coverage of Recommendation No. 1 when the final GAO report is issued.

- Regarding Recommendation No. 4 (a), (b) and (c) on submitting financial and contractual data to the General Services Administration on each ADP equipment component, this requirement constitutes a duplicative and unnecessary administrative burden on the Department of Defense and would be difficult and costly to implement.

Detailed comments are contained in the enclosure. The DoD appreciates the opportunity to comment on the draft report.

Sincerely,

Robert W. Helm

Robert W. Helm
Assistant Secretary of Defense
(Comptroller)

Enclosure

DEPARTMENT OF DEFENSE COMMENTS
GAO DRAFT REPORT - DATED AUGUST 3, 1984
(GAO CODE 913693 - OSD CASE NO. 6578)
"EFFECTIVE MANAGEMENT OF COMPUTER LEASING
NEEDED TO REDUCE GOVERNMENT COSTS"

RECOMMENDATION 1: GAO recommended, in order to ensure that Federal departments and agencies take maximum advantage of available refinancing alternatives, that the heads of Federal agencies with substantial leasing volume require data processing managers to:

(a) evaluate all existing leases and develop a plan to employ, by March 31, 1985, where appropriate, the refinancing alternatives described in this report, and

(b) correct computer equipment inventory and accounting records and maintain them accurately to enable the recurring economic analysis of computer leases.

DOD POSITION: Concur. DoD agrees with the recommendation; however, DoD should be excluded from the coverage of this recommendation when GAO finalizes the report. GAO acknowledged in the draft report that Congress had earlier directed DoD to purchase rather than lease ADPE. DoD has taken the following actions during the January to April 1984 timeframe in response to prior congressional guidance:

a. All DoD Components have reviewed all lease contracts, performed lease/purchase analyses, and planned for purchase of ADPE that is uneconomical to lease. The report of acquisition plans was submitted to Congress on April 1, 1984.

b. All DoD Components have updated ADPE inventory records and are analyzing all acquisitions to determine the most economical financing method.

DoD Components plan to obligate $140 million of the Defense Industrial Fund set up to buy out leased equipment by September 30, 1984, with the remainder of $10 million to be obligated by January 1985. Additional procurement funds to continue the buy out program were included in the President's FY 1985 Defense Budget.

GAO NOTE: See p. 19.

RECOMMENDATION 2: GAO recommended that the Director of Management and Budget require agency heads to certify with each annual budget submission that all agency computer leases have been evaluated for cost effectiveness, and that such leases have been contracted at the most reasonable cost alternative available to the Government.

DOD POSITION: Partially concur. The DoD has issued policy guidance calling for the review of all acquisitions and the selection of the lowest total overall cost alternative for financing. The phrase "agency heads to certify" is inappropriate since, for example, the Secretary of Defense does not possess sure and certain knowledge of each of the many thousands of ADPE acquisition proposals included in the Defense budget. Accordingly, we recommend the phrase be changed to read "require agency heads to assure with each annual budget submission that ...."

GAO NOTE: See p. 19.

RECOMMENDATION 3: GAO recommended that the Administrator of General Services promulgate regulations requiring agencies to perform routine, periodic economic analyses of computer leases and act upon the results.

DOD POSITION: Concur.

RECOMMENDATION 4: GAO recommended, in order to ensure that the necessary leadership and Government-wide ADP management support is forthcoming, that the Administrator of General Services Administration:

(a) Establish and implement procedures to ensure that the ADP-MIS is updated with accurate and timely inventory and financial information;

(b) Collect and analyze financial and contractual information necessary for identifying equipment that could be refinanced at less cost to the Government;

(c) Institute a program, beginning in fiscal year 1985, designed to routinely and periodically analyze the Government-wide ADP inventory to identify and act upon candidates for opportunity buys and the cost effective placement of excess equipment.

DOD POSITION: Partially concur. The DoD agrees that the ADP-MIS should be updated with accurate and timely inventory data. Further, the Department uses the GSA ADP-MIS to enhance the reuse of excess equipment, both owned and leased.

The Department, however, strongly disagrees with the recommendation to submit financial and contractual data to GSA. The DoD can more readily identify candidates for the refinancing of DoD systems than GSA. Implementation of the recommendation would create an additional and duplicative administrative burden, as well as an unnecessary layer of centralized oversight by GSA.

GAO NOTE: See p. 30.

RECOMMENDATION 4: GAO recommended, in order to ensure that the necessary leadership and Government-wide ADP management support is forthcoming, that the Administrator of General Services Administration:

(d) Issue guidelines for agencies in seeking third-party competition and, specifically in transacting sale/leasebacks.

DOD POSITION: Partially concur. The DoD agrees that issuance of guidelines on third-party competition could prove to be beneficial. However, from the standpoint of leasing, the DoD has been directed by the Congress to purchase rather than lease ADP equipment. Therefore, use of the sale/leaseback financing method may be limited by the congressional guidance.

GAO RESPONSE: We agree congressional guidance may limit leasing in Defense, but when Defense does justify leasing--which is permitted by congressional guidance--then it should consider refinancing alternatives such as sell/leasebacks. (See pp. 15 and 19.)

RECOMMENDATION 4: GAO recommended, in order to ensure that the necessary leadership and Government-wide ADP management support is forthcoming, that the Administrator of General Services Administration:

(e) Work with the third-party industry to clearly identify and improve, where possible, those Federal contracting practices that act as major business impediments.

DOD POSITION: Concur. Improvements in procurement procedures could increase and enhance competition in information technology acquisitions.

RECOMMENDATION 4: GAO recommended, in order to ensure that the necessary leadership and Government-wide ADP management support is forthcoming, that the Administrator of General Services Administration:

(f) Institute controls to ensure that the capital budgeted for opportunity buys is available and used only for that purpose.

DOD POSITION: Concur.

RECOMMENDATION 5: GAO recommended that the Director, OMB:

(a) Allow agencies to use the ADP Fund not only for unforeseen purchase opportunities but also to purchase equipment which is currently leased uneconomically; and

(b) Work with GSA and other Federal agencies to determine and request an appropriate level of funding in the ADP Fund so that agencies can buy out uneconomical leases.

DOD POSITION: Concur. In addition, since the DoD is complying with congressional direction to purchase equipment

that is leased, funds already earmarked in Defense budgets for this DoD purchase program should be continued and supported by the OMB.

MATTERS FOR CONSIDERATION OF THE CONGRESS: When considering future requests to increase the ADP Fund, GAO suggested the Congress should specify how much be used exclusively for taking advantage of cost effective opportunities to buy equipment.

DOD POSITION: Concur. See Recommendation 5 response.

(913693)

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICAL BUSINESS
PENALTY FOR PRIVATE USE $300

BULK RATE
POSTAGE & FEES PAID
GAO
PERMIT No. G100

END

FILMED

7-85

DTIC